

COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP  
Form 20-F  
July 11, 2008

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**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, 2007**

**OR**

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

**For the transition period from \_\_\_\_\_ or \_\_\_\_\_**

**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, Brasil**

(Address of principal executive offices)

**Rui de Britto Álvares Affonso**

**[raffonso@sabesp.com.br](mailto:raffonso@sabesp.com.br)**

**(+55 11 3388 8247)**

**Rua Costa Carvalho, 300 05429-900 São Paulo, SP, Brasil**

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

**Title of each class**

**Name of each exchange on which registered**

Common Shares, without par value  
American Depositary Shares, evidenced by American  
Depositary  
Receipts, each representing 2 Common Shares<sup>(1)</sup>

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.

<sup>(1)</sup> Until June 8, 2007, American Depositary Shares, evidenced by American Depositary Receipts, each representing 250 Common Shares.

**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.**

227,836,623 Common Shares, without par value, as of December 31, 2007

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

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

Item 17 Item 18

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

Yes

No

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## PRESENTATION OF FINANCIAL INFORMATION

In this annual report, references to *real*, *reais* or R\$ are to the Brazilian *real*, the official currency of Brazil. All references to U.S. dollars or US\$ are to United States dollars. Solely for the convenience of the reader, we have translated some of the *real* amounts contained in this annual report into U.S. dollars at a rate equal (unless otherwise indicated) to R\$1.7713 to US\$1.00, the commercial selling rate as of December 31, 2007 as reported by the Central Bank of Brazil, or the Central Bank. As a result of the recent fluctuations in the *real*/U.S. dollar exchange rate, the commercial selling rate may not be indicative of current or future exchange rates. Therefore, you should not read these translations as representations that any such amounts have been, could have been or could be converted into U.S. dollars at that or at any other exchange rate. See *Item 3.A. Selected Financial Data Exchange Rates* for information regarding exchange rates allocable to the Brazilian currency since January 1, 2002.

Our audited financial statements as of December 31, 2006 and 2007 and for the years ended December 31, 2005, 2006 and 2007 are included in this annual report. The financial statements as of and for the years ended December 31, 2005, 2006 and 2007 have been audited by Deloitte Touche Tohmatsu Auditores Independentes, São Paulo, Brazil. The selected financial data as of December 31, 2003 and 2004 is derived from our financial statements audited by Deloitte Touche Tohmatsu Auditores Independentes for the year ended December 31, 2003 and 2004, both included in previously filed annual reports.

Our audited financial statements are presented in *reais* and are prepared in accordance with the Brazilian Corporate Law Method, which is based on Brazilian Corporate Law (Law No. 6,404/76, as amended), the rules and regulations issued by the Brazilian Securities Commission (*Comissão de Valores Mobiliários*), or CVM, and the accounting standards issued by the Brazilian Institute of Independent Auditors (*Instituto dos Auditores Independentes do Brasil*), or IBRACON, hereinafter referred to as the Brazilian Corporate Law Method.

Like other Brazilian companies, we have the option of presenting our primary financial statements on the basis of accounting principles established in accordance with the Brazilian Corporate Law Method with a reconciliation to generally accepted accounting principles in the United States of America, or U.S. GAAP. Unless otherwise indicated, our financial statements and all financial data included in this annual report have been prepared in accordance with the Brazilian Corporate Law Method.

The Brazilian Corporate Law Method differs in significant respects from U.S. GAAP. Note 26 to our financial statements provides a description of the differences between the Brazilian Corporate Law Method and U.S. GAAP as they relate to our financial statements and a reconciliation from the Brazilian Corporate Law Method to U.S. GAAP, for periods presented therein, of our net income and shareholders' equity. The reconciliation from the financial statements prepared in accordance with the Brazilian Corporate Law Method to U.S. GAAP includes, among others, adjustments for differences related to the accounting for past revaluations of property, plant and equipment, historical inflation accounting and accounting for pension and other employee benefits.

All information related to liters, water and sewage volumes, number of employees, kilometers, water and sewage connections, population served, operating productivity, water production rate, sewage lines (in kilometers), savings achieved and investments in improvement programs have not been audited.

### Other Information

We do not have any subsidiaries.

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. Brazil refers to the Federative Republic of Brazil

and State refers to the State of São Paulo, which is also our controlling shareholder. The phrases Federal Government and Brazilian government refer to the federal government of the Federative Republic of Brazil and State government refers to the state government of the State of São Paulo.

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In this annual report, we refer to the São Paulo Metropolitan Region, the area where the Metropolitan Executive Office operates, comprising 38 municipalities, including the City of São Paulo. We refer to the Regional Systems, the area where the Regional Systems Executive Office operates, comprising 328 municipalities in the interior and coastline regions of the State of São Paulo. As of the date of this annual report, we provide water supply and sewage services to a total of 366 of the 645 municipalities in the State of São Paulo.

References to Water Coverage Ratio in this annual report mean the ratio between the number of residences connected to the water supply network, divided by the number of urban residences in a certain area. References to Sewage Coverage Ratio mean the ratio between the number of residences connected to the sewage collection network, divided by the number of urban residences in a certain area.

References to urban and total population in this annual report are estimated based on a research made by State System Foundation Data Analysis (*Fundação Sistema Estadual de Análise de Dados - SEADE*): Projections for the State of São Paulo Population and Residences until 2025 ( *Projeções para o Estado de São Paulo - População e Domicílios até 2025* ).

**FORWARD-LOOKING STATEMENTS CONTAINED IN THIS ANNUAL REPORT**

This annual report includes forward-looking statements, principally 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 things:

- general economic, political and other conditions in Brazil and in other emerging market countries;
- existing and future governmental regulation, including taxes on, and charges to, us;
- changes to tax laws in Brazil;
- inflation and currency devaluation in Brazil;
- the interests of our controlling shareholder, the State of São Paulo;
- our ability to collect amounts owed to us by our controlling shareholder and by municipalities;
- our ability to continue to use certain reservoirs within the present terms and conditions;
- our ability to continue to be able to pass on to our tariffs expenses that we incur in connection with the use of water;
- our capital expenditure program and other liquidity and capital resources requirements;
- limitations on our ability to increase and readjust tariffs;
- droughts, water shortages and climate events;
- power shortages or rationing in energy supply or significant changes in energy tariffs;
- our lack of formal concessions for the City of São Paulo and other municipalities including the cities comprising the São Paulo Metropolitan Region;
- municipalities' power to terminate our existing concessions;
- our ability to provide water and sewage services in additional municipalities and to maintain current rights to provide such services;
- the size and growth of our customers' base;
- our ability to maintain universalization of Water Coverage in the municipalities to which we provide water services and to increase Sewage Coverage Ratio;
- our ability to gain access to attractive financing in the future;
- our level of indebtedness and limitations on our ability to incur additional indebtedness;
- our costs relating to compliance with environmental laws and potential penalties for failure to comply with these laws;
- the outcome of our pending or future legal proceedings;
- our management's expectations and estimates concerning our future financial performance;
- the creation of the São Paulo State Sanitation and Energy Regulatory Agency - ARSESP and its impacts;
- other risk factors as set forth under *Item 3.D. Risk Factors*.

The words believe, may, will, estimate, continue, anticipate, plan, intend, expect and similar words 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 the 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 guarantees of future performance and involve risks.



**PART I**

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

**1.A. Directors and Senior Management**

Not applicable.

**1.B. Advisers**

Not applicable.

**1.C. Auditors**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

**2.A. Offer Statistics**

Not applicable.

**2.B. Method and Expected Timetable**

Not applicable.

**ITEM 3. KEY INFORMATION**

**3.A. Selected Financial Data**

The data in this section as of December 31, 2006 and 2007 and for each of the three years ended December 31, 2007 have been derived from our audited financial statements, which appear elsewhere in this document. The selected financial data as of December 31, 2003, 2004 and 2005, and for each of the two years ended December 31, 2004 have been derived from our audited financial statements, which do not appear elsewhere in this document.

Our financial statements have been prepared in accordance with the Brazilian Corporate Law Method, which differs in significant respects from U.S. GAAP (see note 26 to our financial statements). You should read this selected financial data in conjunction with our financial statements and the related notes thereto included in this annual report. Solely for the convenience of the reader, *real* amounts as of and for the year ended December 31, 2007 have been translated into U.S. dollars at the selling rate as of December 31, 2007 of R\$1.7713 per US\$1.00.

The following table presents our selected financial data as of and for each of the periods indicated.

**As of and for the year ended December 31,**

**2003                      2004                      2005                      2006                      2007**

**(in millions, except per share and per ADS data)**

**Brazilian Corporate Law Method**

	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>	<b>US\$</b>
<b>Statement of operations data:</b>						
Net revenue from sales and services	4,130.8	4,397.1	4,953.4	5,527.3	5,970.8	3,370.9
Cost of sales and services	(2,067.1)	(2,253.4)	(2,376.4)	(2,616.8)	(2,695.7)	(1,521.9)
Gross profit	2,063.6	2,143.7	2,577.0	2,910.5	3,275.1	1,849.0
Selling expenses	(297.5)	(502.5)	(537.8)	(719.2)	(639.6)	(361.1)
Administrative expenses	(254.1)	(313.6)	(349.6)	(387.4)	(559.2)	(315.7)
Financial income (expenses), net	(346.5)	(503.7)	(447.0)	(563.3)	(560.9)	(316.7)
Income from operations <sup>(1)</sup>	1,165.5	823.9	1,242.6	1,240.6	1,515.4	855.5
Non-operating income (expenses), net	(54.5)	(33.9)	(25.4)	(50.9)	(35.1)	(19.9)
Income before taxes on income	1,111.1	790.0	1,217.2	1,189.7	1,480.3	835.6
Income tax and social contribution	(242.6)	(241.9)	(316.5)	(375.7)	(431.6)	(243.6)
Extraordinary item, net of income and social contribution taxes <sup>(2)</sup>	(35.1)	(35.1)	(35.1)	(35.1)	-	-
Net income	833.3	513.0	865.6	778.9	1,048.7	592.0
Net income per 1,000 common shares (per share in 2007)*	29.26	18.01	30.40	27.35	4.60	2.60
Net income per ADS	7.32	4.50	7.60	6.84	9.20	5.20
Dividends and interest on shareholders equity per 1,000 common shares (per share in 2007)*	17.70	5.37	12.23	9.51	1.32	0.75
Number of common shares outstanding at year end (in thousands of shares) <sup>(9) *</sup>	28,479,578	28,479,578	28,479,578	28,479,578	227,836	227,836
<b>Balance sheet data:</b>						
Cash and cash equivalents	281.0	105.6	280.2	328.2	465.0	262.5
Customer accounts receivables, net	1,056.2	1,227.9	1,332.5	1,407.9	1,486.7	839.3
Reimbursement for pension benefits paid	491.0	576.3	672.7	774.5	879.1	496.3
Short and long-term receivables from shareholders, net <sup>(3)</sup>	164.2	245.6	420.4	456.9	446.4	252.0

\*After June 4, 2007 our common shares have been traded considering a reverse stock split of 125 common shares into one common share. To convert from *Reais* per 1,000 common shares to *Reais* per share, for 2003, 2004, 2005 and 2006 the price per 1,000 common shares must be divided by 1,000 and multiplied by 125.

Table of Contents**As of and for the year ended December 31,**

	2003	2004	2005	2006	2007
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**(in millions, except per share and per ADS data)**

	R\$	R\$	R\$	R\$	R\$	US\$
Property, plant and equipment, net	13,376.6	13,523.5	13,613.6	13,837.5	14,060.1	7,937.7
Concession assets acquired, net	686.6	517.4	502.5	495.1	507.8	286.7
Total assets	16,590.1	16,783.8	17,431.1	18,000.0	18,663.4	10,536.5
Total short-term loans and financing	997.0	1,496.8	759.0	852.5	742.1	419.0
Total long-term loans and financing	6,267.3	5,553.8	5,905.2	5,474.3	4,943.1	2,790.7
Interest on shareholders' equity	504.1	152.9	348.2	270.8	300.7	169.8
Total liabilities	9,013.2	8,832.2	8,948.5	8,981.5	8,879.4	5,012.9
Shareholders' equity	7,576.9	7,951.6	8,482.5	9,018.5	9,784.0	5,523.6
<b>Other financial information:</b>						
Cash provided by operating activities <sup>(4)</sup>	1,655.3	1,441.1	1,737.6	2,020.8	2,215.6	1,250.8
Cash used in investing activities <sup>(4)</sup>	(650.8)	(675.5)	(643.2)	(850.0)	(881.7)	(497.8)
Cash used in financing activities <sup>(4)</sup>	(1,138.2)	(941.1)	(919.7)	(1,122.8)	(1,197.1)	(675.8)
Adjusted EBITDA <sup>(5)</sup>	2,076.5	1,926.5	2,285.6	2,446.1	2,698.8	1,523.7
Capital expenditures <sup>(4)</sup>	641.3	670.3	643.1	855.1	881.7	497.8
Depreciation and amortization	564.5	598.9	596.0	642.2	622.5	351.5

**As of and for the year ended December 31,**

	2003	2004	2005	2006	2007
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**(in millions, except per share and per ADS data)****U.S. GAAP**

	R\$	R\$	R\$	R\$	R\$	US\$
<b>Statement of operations data:</b>						
Net revenue from sales and services	4,130.8	4,397.1	4,953.4	5,527.3	5,970.8	3,370.9
Gross profit	1,853.3	1,953.1	2,383.2	2,704.8	3,122.3	1,762.7
Selling expenses	(323.4)	(521.5)	(555.4)	(737.3)	(648.1)	(365.9)
Administrative expenses	(276.3)	(324.1)	(350.2)	(428.7)	(609.9)	(344.3)
Income from operations <sup>(6)</sup>	1,136.5	1,073.0	1,470.2	1,451.4	1,840.9	1,039.3
Financial income (expenses), net	(329.4)	(479.2)	(401.9)	(542.3)	(520.8)	(294.0)
Net income	642.6	417.5	791.2	622.5	925.4	522.5
Net income per common shares- basic and diluted	2.82	1.83	3.47	2.73	4.06	2.29
Net income per ADS-basic and diluted	5.64	3.67	6.95	5.46	8.12	4.59

Weighted average number  
of common

shares outstanding<sup>(9)</sup> 227,836,623 227,836,623 227,836,623 227,836,623 227,836,623 227,836,623

**Balance sheet data:**

Property, plant and equipment, net	15,268.9	15,347.2	15,393.9	15,473.5	15,621.0	8,818.9
Concession assets acquired, net	686.6	517.4	502.5	495.1	507.8	286.7
Total assets	17,630.4	17,704.5	18,209.8	18,498.7	18,928.9	10,686.4
Short-term loan financing	997.0	1,496.8	759.0	852.5	742.1	419.0
Long-term loan financing	6,267.3	5,553.8	5,905.2	5,459.9	4,925.4	2,780.7
Interest on shareholders equity	504.1	152.9	348.2	270.8	300.7	169.8
Total liabilities	11,604.3	11,339.7	11,388.4	11,200.5	11,037.3	6,231.2
Shareholders equity	6,085.6	6,364.8	6,821.4	7,298.2	7,891.6	4,455.3

## As of and for the year ended December 31,

	2003	2004	2005	2006	2007
<b>Operating data (at period end):</b>					
Number of water connections (in thousands)	6,044	6,358	6,489	6,609	6,767
Number of sewage connections (in thousands)	4,462	4,747	4,878	5,002	5,167
Percentage of population with water connections (%)	100	100	100	99	99
Percentage of population with sewer connections (%)	78	78	78	78	79
Volume of water billed during period (in millions of cubic meters)	1,765	1,692	1,759	1,807	1,847
Water loss percentage during period (average)(%) <sup>(7)</sup>	33.0	34.0	32.4	31.9	29.5
Water loss per connection (average) <sup>(8)</sup>	563	547	520	511	467
Number of employees	18,546	17,735	17,448	16,978	16,850

(1) Includes financial expenses, net.

(2) The extraordinary item charged to income in the years ended December 31, 2003, 2004, 2005 and 2006 relates to the amortization (over a five-year period) of the actuarial liability recorded on December 31, 2001 upon first time recognition of the defined benefits pension plan. The presentation of the charge as an extraordinary item is consistent with the instructions of the CVM and the Brazilian Corporate Law Method. For purposes of U.S. GAAP, the pension expense has been treated as a payroll expense from the first year presented.

(3) Short and long-term receivables from shareholders, net represent amounts due from the State for water and sewage services. See note 6 to our financial statements.

(4) Based upon the statements of cash flows for the years ended December 31, 2007, 2006 and 2005 included in note 28 to our financial statements and the statements of cash flows for the years ended December 31, 2004 and 2003 which are not included in this annual report.

(5) The inclusion of Adjusted EBITDA information aims at presenting a measure for our economic operating performance. Our Adjusted EBITDA means net income before financial expenses, net, income tax and social contribution tax (federal taxes on income), depreciation and amortization, non-operating income (expenses) and extraordinary item, net of income tax and social contribution. Adjusted EBITDA is not a measure of financial performance recognized under the Brazilian Corporate Law Method, and should not be considered individually or as an alternative for net income, as a measure of operating performance, or alternative for operating cash flows, or as a measure of liquidity. Our definition of Adjusted EBITDA or EBITDA may not be comparable with the definition of Adjusted EBITDA or EBITDA used by other companies. Our Adjusted EBITDA works as a general indicator of economic performance and it is not affected by debt restructurings, interest rate fluctuations, changes in tax burden or in depreciation and amortization levels. Consequently, we believe that Adjusted EBITDA works as an adequate tool to regularly compare our operating performance. Additionally, Adjusted EBITDA is used in covenants related to some of our financial commitments. We believe that Adjusted EBITDA allows a better understanding not only of our financial performance but also of our capacity to satisfy our liabilities and to raise funds for our capital expenditures and working capital. Adjusted EBITDA, however, has limitations that prevent it from being used as a measure of our profitability because it does not take into consideration other costs resulting from our business or certain other costs,

which could significantly affect our profits, such as financial expenses, taxes, depreciation, capital expenses and other related charges. Adjusted EBITDA calculation presented herein is in accordance with the rules issued by the Brazilian regulatory authorities, which set forth the Brazilian Corporate Law Method. The table below sets forth, for the periods indicated, the reconciliation between our net income with Adjusted EBITDA:

	For the year ended December 31,					
	2003	2004	2005	2006	2007	
	(in millions)					
	R\$	R\$	R\$	R\$	R\$	US\$
<b>Brazilian Corporate Law Method</b>						
Net income (loss)	833.3	513.0	865.6	778.9	1,048.7	592.0
<b>Add:</b>						
Financial expenses (income), net	346.5	503.7	447.0	563.3	560.9	316.7
Income tax and social contribution	242.6	241.9	316.5	375.7	431.6	243.6
Depreciation and amortization	564.5	598.9	596.0	642.2	622.5	351.5
Non-operating income (expenses), net	54.5	33.9	25.4	50.9	35.1	19.9
Extraordinary item, net of income and social contribution taxes	35.1	35.1	35.1	35.1	-	-
Adjusted EBITDA	2,076.5	1,926.5	2,285.6	2,446.1	2,698.8	1,523.7

(6) Under U.S. GAAP, income from operations is determined before financial expenses, net.

(7) Includes both physical and non-physical losses. Water loss percentage represents the quotient of (a) the difference between (i) the total amount of water produced by us less (ii) the total amount of water invoiced by us to customers minus (iii) the volume of water set out below that we exclude from our calculation of water losses, divided by (b) the total amount of water produced. We exclude from our calculation of water losses the following: (1) water discharged for periodic maintenance of water mains and water storage tanks; (2) water supplied for municipal uses such as firefighting; (3) water we consume in our facilities; and (4) estimated water losses associated with water we supply to *favelas* (shantytowns).

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(8) Measured in liters/connections per day, according to the new method of measuring our water losses, based on worldwide market practice for the sector. See *Item 4.B. Information on the Company Business Overview*.

(9) In 2007 we approved a reverse stock split of 125 common shares into one common share. Under U.S. GAAP the SFAS N°128 requires the retroactive restatement of earnings-per-share computations for stock dividends, stock splits, and reverse splits (see note 26 (r) to our financial statements).

**Exchange Rates**

Before March 14, 2005, there were two principal legal foreign exchange markets in Brazil, the commercial rate exchange market and the floating rate exchange market. On March 4, 2005, the Brazilian National Monetary Council (*Conselho Monetário Nacional*) enacted Resolution No. 3,265, pursuant to which the floating rate market and the commercial market were unified under the denomination exchange market, effective as of March 14, 2005. The new regulation allows the purchase and sale of foreign currency and the international transfer of *reais* by any person or legal entity, regardless of the amount, provided, however, the transaction is legal and subject to certain regulatory procedures.

Since 1999, the Central Bank has allowed the *real*/U.S. dollar exchange rate to float freely, and, since then, the *real*/U.S. dollar exchange rate has fluctuated considerably. Since the beginning of 2001, the Brazilian exchange market has been increasingly volatile, and, until early 2003, the value of the *real* declined relative to the U.S. dollar. The *real* appreciated against the U.S. dollar in 2003, 2004, 2005, 2006 and 2007. As of December 31, 2007, the exchange rate for U.S. dollars was R\$1.7713 per U\$1.00. In the past, the Central Bank has intervened occasionally to control unstable movements in foreign exchange rates. 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 market through the return of a currency band system or otherwise. The *real* may depreciate or appreciate against the U.S. dollar substantially in the future. For more information on these risks, see *Item 3.D. Risk Factors Risks Relating to Brazil*.

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

	<b>Year-end</b>	<b>Average for year<sup>(1)</sup></b>	<b>Low</b>	<b>High</b>
	<b>(reais per U.S. dollar)</b>			
<b>Year</b>				
2003	2.8892	3.0715	2.8219	3.6623
2004	2.6544	2.9257	2.6544	3.2051
2005	2.3407	2.4341	2.1633	2.7621
2006	2.1380	2.1771	2.0586	2.3711
2007	1.7713	1.9483	1.7325	2.1556

	<b>Period-end</b>	<b>Average for period<sup>(2)</sup></b>	<b>Low</b>	<b>High</b>
	<b>(reais per U.S. dollar)</b>			
<b>Month</b>				
January 2008	1.7603	1.7743	1.7414	1.8301
February 2008	1.6833	1.7277	1.6715	1.7681



March 2008	1.7491	1.7076	1.6700	1.7491
April 2008	1.6872	1.6889	1.6575	1.7534
May 2008	1.6294	1.6605	1.6294	1.6949
June 2008	1.5919	1.6189	1.5919	1.6428

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Source: Central Bank

(1) Represents the average of the exchange rates of each trading date.

(2) Represents the average of the lowest and highest rates in the month.

Exchange rate fluctuations will affect the U.S. dollar equivalent of the *real* price of our common shares on the Bovespa as well as the U.S. dollar equivalent of any distributions we make in *reais* with respect to our common shares.

**3.B. Capitalization and Indebtedness**

Not applicable.

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

Not applicable.

**3.D. Risk Factors****Risks Relating to Brazil**

*The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This involvement, as well as Brazilian political and economic conditions, could adversely affect us and the market price of our 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, increases in interest rates, changes in tax policies, price and tariff controls, currency devaluations, capital controls and limits on imports. Our business, financial condition and results of operations, as well as the market price of our 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 contracts;
- interest rates;
- exchange controls and restrictions, such as those which were briefly imposed in 1989 and 1990;
- currency fluctuations;
- inflation;
- liquidity of the Brazilian capital and lending markets;
- tax and regulatory policies; and
- other political, social and economic developments in or affecting Brazil.

Uncertainty over whether the Brazilian government will implement changes in policy or regulation affecting these or other factors in the future may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets and in the securities issued abroad by Brazilian issuers, which could have a material adverse effect on us and on our shares and ADSs.

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

Brazil experienced extremely high rates of inflation in the past. Inflation and the Brazilian government's measures to fight inflation have had significant negative effects on the Brazilian economy, contributing to economic uncertainty and heightened volatility in the Brazilian securities markets. The Brazilian government's measures to control inflation have often included maintaining a tight monetary policy with high interest rates, thereby restricting the availability of credit and reducing economic growth. The official overnight interest rate in Brazil, (SELIC), at the end of 2005, 2006 and 2007 was 18.00%, 13.19% and 11.18%, respectively, in line with the target rate set by the Brazilian Committee on Monetary Policy (*Comitê de Política Monetária*), or COPOM. On June 30, 2008, the official interest rate in Brazil was 12.25% .



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The annual rate of inflation, as measured by the General Market Price Index (*Índice Geral de Preços Mercado*), or IGP-M index, has fallen from 9.95% in 2000 to 3.83% in 2006 and increased to 7.75% in 2007. If Brazil again experiences high inflation, our costs and expenses may rise and our overall financial performance may be adversely affected. In addition, a substantial increase in inflation may weaken investor's confidence in Brazil, causing the decline in the market value of our shares or ADSs.

Additionally, in the event of an increase in inflation, the Brazilian government may choose to raise official interest rates. Increases in interest rates would not only affect our cost of funding, but could also have a material adverse effect on us and may also adversely affect the market value of our shares or ADSs.

***Exchange rate instability may adversely affect us and the market price of our shares or ADSs.***

The Brazilian currency experienced frequent and substantial devaluations in relation to the U.S. dollar and other foreign currencies during the last decades. Throughout this period, the Brazilian government has implemented various economic plans and utilized a number of exchange rate policies, including sudden devaluations, periodic mini-devaluations during which the frequency of adjustments has ranged from daily to monthly, floating exchange rate systems, exchange controls and dual exchange rate markets. From time to time, there have been significant fluctuations in the exchange rate between the Brazilian *real* and the U.S. dollar and other currencies. For example, the *real* depreciated against the U.S. dollar by 9.3% in 2000, 18.7% in 2001 and 34.3% in 2002. Although the *real* appreciated 13.4%, 9.5% and 20.7% against the U.S. dollar in 2005, 2006 and 2007, respectively, no assurance can be given that the *real* will not depreciate against the U.S. dollar again. On June 30, 2008, the exchange rate was R\$ 1.5919 per US\$1.00.

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, particularly because our tariff revenue and other sources of income are based solely in *reais*. In addition, because we have foreign currency-denominated indebtedness, any significant devaluation of the *real* during a financial period will increase our financial expenses as a result of foreign exchange losses that we must record. We had total foreign currency-denominated indebtedness of R\$1,242.3 million as of December 31, 2007, and we anticipate that we may incur substantial amounts of foreign currency-denominated indebtedness in the future. Our overall results of operations were positively affected by the 20.7% appreciation of the *real* against the U.S. dollar in 2007, which amounted to R\$188.4 million. We do not currently have any hedging 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 shares or ADSs.

***Developments and the perception of risk in other countries, especially emerging market countries, may adversely affect our financing and the market price of our shares or ADSs.***

The market value of securities of Brazilian issuers is affected to varying degrees by economic and market conditions in other countries, including other Latin American and emerging market countries. Although economic conditions in those 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 value of securities of Brazilian issuers. Crises in other emerging countries may diminish investors' interest in securities of Brazilian issuers, including our securities. This could adversely affect the market price of our shares or ADSs and could also make it more difficult for us to gain access to the capital markets and finance our operations in the future on acceptable terms, or at all.

**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 ours or from minority shareholders interests, and which could have a material adverse effect on us.***

The State of São Paulo, through its ownership of our common shares, has the ability to determine our operating policies and strategy, to control the election of a majority of the members of our board of directors and to appoint our senior management. As of December 31, 2007, the State owned 50.3% of our outstanding common shares.

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The State has from time to time in the past, and may in the future, through its control of our board of directors, direct that we engage in certain business activities and make certain expenditures that promote political, economic or social goals but that do not necessarily also enhance our business and results of operations. See *Item 5.A. Operating and Financial Review and Prospects Factors Affecting Our Results of Operations*.

Newly elected Governors of the State typically make significant changes in our board of directors and senior management and, historically, the chairman of our board of directors has been the Secretary of State for the State Secretariat for Sanitation and Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*).

***We have a substantial amount of accounts receivable owed to us by the State and some State entities, and we cannot assure you as to when or whether the State will pay us.***

Historically, the State and some State entities have had substantial overdue accounts payable to us relating to (1) the provision of water and sewage services and (2) 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. As of December 31, 2007, the amounts owed to us by the State for the provision of water and sewage services totaled R\$446.4 million and, with respect to payment of pensions on behalf of the State, the State owed us R\$879.1 million. Amounts owed to us by the State for water and sewage services and reimbursements for pensions paid may increase in the future.

We have entered into agreements with the State to settle these overdue amounts payable to us. For a detailed discussion of these agreements, see *Item 7.B. Major Shareholders and Related Party Transactions Related Party Transactions*, and note 6 (ii), (iii), (iv), (v) to our financial statements. Pursuant to these agreements, the amounts due with respect to water and sewage services could be settled through the application of dividends payable to the State by us to the repayment of amounts owed to us through December 2007. The second amendment signed on December 2007, does not require the application of dividends to offset accounts receivable from the State. The second amendment instead requires the: i) implementation of an electronic account management system; ii) structuring of the Rational Water Use Program (PURA) to ration the consumption of water and the amount of the water and sewage bills under the responsibility of the State; iii) establishment, by the State, of criteria for budgeting; iv) possibility of registering State bodies and entities in a delinquency system or reference file; v) possibility of interrupting water supply to State bodies and entities in the case of nonpayment of water and sewage bills. Furthermore, there can be no assurance that the government will pay the total amount owed to us. On March 26, 2008, the São Paulo State Government and we, entered into a commitment agreement for the settlement of outstanding debts related to the reimbursement of pension benefits. Pursuant to the commitment agreement, part of the amounts due to us with respect to payments of pensions on behalf of the State may be settled through the transfer to us of certain reservoirs in the Alto Tietê system that we use and are owned by the State. We are unable to predict whether and when these reservoirs will be transferred to us because the Public Prosecution Office of the State of São Paulo (Ministério Público do Estado de São Paulo) filed a civil public action alleging that a transfer to us of ownership of the Alto Tietê system reservoirs is illegal. See *Item 8.A. Consolidated Statements and other Financial Information Legal Proceedings*.

We cannot assure you as to when or if the State will pay overdue amounts owed to us. In addition, even though the State acknowledges its debts to us related to pension benefits, the State disagrees with the criteria adopted by us to grant and pay the benefits. The State based its disagreement on legal opinions issued by the State Attorney General, which restrict State actions and prevent the voluntary reimbursement of amounts paid by us. 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 technical and court levels. Should this dispute persist, we will take all the necessary actions to protect our interests. Due to the State's history of not making timely payments to us in respect of services and of not reimbursing us in a timely manner for the payments of pensions on behalf of the State, we cannot assure you that the amount of accounts receivable owed to us by the State and some State entities will not significantly increase in the future. In addition, we have not established any provisions for any amounts due to us by the State, as

we do not expect to incur any significant losses relating to these amounts. If the State does not pay the amount it owes to us, we will be adversely affected.

***We may be required to acquire reservoirs that we use and that are owned by a State-controlled company, or we may be required to pay substantial charges to the owner with respect to our use of these reservoirs.***

In connection with the provision of water services, we use the Billings and Guarapiranga reservoirs that are owned by a State-controlled company. Our right to use these reservoirs is provided for through a grant issued by the State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo DAEE*). The State, through its control of our board of directors, could require us to acquire the Billings and Guarapiranga reservoirs. As a result of these acquisitions, our cash position and overall financial condition could be adversely affected. In addition, since we are not currently charged for the use of these reservoirs, we are uncertain as to whether we will continue to be able to use the reservoirs without paying charges, or what the likely fee scale would be, if imposed. We may also be required to pay additional maintenance and operational costs for our use of the Billings and Guarapiranga reservoirs. If we were required to pay substantial charges to the owner or additional maintenance or operational costs for our use of these properties, we could be adversely affected.

### **Risks Relating to Our Business**

***We cannot anticipate the effects that the new legislation enacted in January 2007 will have on the basic sanitation sector in Brazil.***

On January 5, 2007, Law No. 11,445 was enacted to regulate the basic sanitation industry in Brazil. Although this law has been enacted for more than one year, it is in its initial stage of implementation and we cannot anticipate the effects that it will have on our operations and business. In compliance with Law No. 11,445, the State of São Paulo created in December 2007, ARSESP – the São Paulo State Sanitation and Energy Regulatory Agency, which is the regulatory agency that regulates the basic sanitation services pertaining to the State, respecting their federal and municipal jurisdictions and prerogatives and exercising the following functions:

- complying with and enforcing state and federal basic sanitation legislation;
- publishing the organizational platform for the services, indicating the types of services provided by the state as well the equipment and facilities composing the system;
- assuming, where applicable, the legal attributions of the jurisdictional authority;
- establishing, in accordance with the tariff guidelines defined by the decree, tariffs and other manners for the compensation of services, adjusting and reviewing them to ensure the financial-economic balance of services and low-cost tariffs through mechanisms that increase service efficiency and lead to the appropriation of productivity gains by society; and
- to approve, oversee and regulate (including tariff issues) sewage treatment and wholesale water supply agreements entered into between the state supplier and other suppliers, pursuant to Article 12 of new basic sanitation law.

There are several uncertainties related to the new legislation which could have a material adverse effect on us. See *Item 4.B. Business Overview The Basic Sanitation Law Public Consortia Law and Cooperation Agreements.*

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

Our industry is specifically affected by the following risks associated with the provision of water and sewage services:

- we may become subject to substantial water-related and sewage-related charges imposed by governmental water agencies of the State and of the Federal Government related to the abstraction of water from, or dumping of sewage into, water resources controlled by these agencies, which we may not be able to pass on to our customers. See *Item 4.B. Business Overview Government Regulation Water Usage* ;





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- in some cases, we are required to continue providing services to certain municipalities to which we provide water on a wholesale basis that have overdue amounts owed to us and are not paying us on a regular basis and we cannot assure you as to when or whether these municipalities will pay us;
- our tariffs may not increase in line with increases in inflation and operating expenses, including taxes, or to increase them in a timely manner, due to political and legal constraints that may hinder us from passing on to our customers increases in our cost structure. These constraints may also have an adverse effect on our capability to fund our capital expenditure program and financing activities and to meet our debt service requirements. see *Item 5.A. Operating and Financial Review and Prospects Factors Affecting Our Results of Operations Effects of Tariff Increases* ;
- we are exposed to droughts that may adversely affect our water supply systems, resulting in a decrease in the volume of water distributed and billed as well as in the revenue from water supply; and
- we are dependent upon energy to conduct our operations and shortages or rationing of energy may prevent us from providing water and sewage services and may also cause material damages to our water and sewage systems when we resume operations. Also, we may not be able to pass on to customers significant increases in energy tariffs.

The occurrence of any of the above may have a material adverse effect on us.

***We do not hold formal concessions to provide water and sewage services to the City of São Paulo and several other municipalities that we serve, and therefore we may not be able to enforce our rights to continue to provide services in these municipalities.***

Our operations are concentrated in the City of São Paulo with which we have not entered into a concession contract. As of December 31, 2007, the City of São Paulo accounted for 56.3% of our sales and services rendered. In addition, we do not hold formal concessions in 36 other municipalities in the State of São Paulo, particularly in the municipality of Santos, in the coastal region, where we operate under a deed of authorization (*escritura pública de autorização*) and that has a significant population of approximately 428,000 as of December 31, 2007.

Because we do not hold concessions or formal contract rights to provide services in these municipalities, we may not be able to effectively enforce our right to continue to provide services or to be paid for the services we provide. In the future, our rights in respect of the City of São Paulo and these other municipalities could be modified or adversely affected by Brazilian federal, state or local governmental actions, judicial decisions or other factors.

From time to time, mayors of the City of São Paulo have initiated or proposed discussions with the State regarding entering into a formal concession contract with us to provide water and sewage services in the City of São Paulo. For a detailed discussion of these initiatives, see *Item 4.B. Business Overview Government Regulation Concessions*.

The sanitation legislation, Law No. 11,445, enacted in January 2007, sets December 31, 2010 as the deadline for water and sewage service companies, such as us, to regularize the provision of water and sewage services to municipalities, in case there is no formal concession to provide services to municipalities. We cannot anticipate the terms and conditions of these contracts and their effects on the provision of our services in these municipalities, particularly with respect to the City of São Paulo which is awaiting a court ruling regarding the ownership of services in metropolitan regions.

In the case of the City of São Paulo, in November 2007, we entered into a cooperation agreement with the City of São Paulo that determined certain basic sanitation and environmental actions and resolved outstanding financial obligations of the City of São Paulo until it is possible to formalize definitive legal instruments that assure stability in the provision of public basic sanitation services, regardless of the substance of the legal ruling currently awaited.

Furthermore, we cannot assure you when and if there will be changes to the conditions under which we currently provide water and sewage services to these municipalities without holding formal concessions and we cannot anticipate their effects on the provision of our services in the City of São Paulo and in these other municipalities.

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We may face difficulties to continue to provide water and sewage services in the municipalities we serve and we cannot assure you that these municipalities will continue to require our provision of services under the same terms. At the end of 2007, we were a provider of water and sewage services to 366 municipalities, although, due to judicial orders, we had temporarily stopped operating three of them (Araçoiaba da Serra, Cajobi e Monte Alto). We have recently resumed providing service to Monte Alto. As for the other two municipalities (Araçoiaba da Serra and Cajobi) we are still in litigation. Even if we cannot resume providing services to these municipalities, there will be no major impact on us as: i) revenue from these operations account for less than 0.2% of our total revenues, and ii) we will continue to be entitled to indemnities related to the assets invested in these municipalities and not yet amortized. Substantially all of these concessions have 30-year terms. As of December 31, 2007, we had 106 program contracts in place. In December 2008, 104 concession contracts will expire or be under negotiation with the respective municipalities. Between 2009 and 2034, 117 concession contracts will expire. The remaining concession contracts have no expiration date. As of December 31, 2007, the carrying value of our assets at the municipalities with concession contracts under negotiation or expiring in 2007 and 2008 totaled R\$ 2.02 billion and revenues from these municipalities for the year ended December 31, 2007 totaled R\$935 million.

In case certain municipalities continue to require our provision of water and sewage services, we cannot assure you that we will obtain in the new contracts the same terms under which we currently provide services to them because the new basic sanitation law prevents us from planning, regulating and monitoring our services and it requires a more stringent control by the municipalities or by the São Paulo State Sanitation and Energy Regulatory Agency (ARSESP), which was created by the São Paulo State government through Supplementary Law 1,025 of December 7, 2007.

In case certain municipalities no longer require our provision of water and sewage services, we may be adversely affected. See *Item 4.B. Business Overview Our Operations* and *Item 4.B. Business Overview Government Regulation Public Consortia Law and Cooperation Agreements*.

We may also face difficulties in continuing to provide water and sewage services to certain municipalities by means of new contracts because of an increase in competition and in case we are outbid from a public bidding process.

***Municipalities may terminate our concessions before their expiration and the compensation may be inadequate to recover the full value of our investments.***

The concessions we hold are subject to early termination by the municipalities under certain circumstances. Municipalities may terminate our concessions if we fail to comply with our obligations under the relevant concession contract and applicable law, or if the municipality determines, based on authorization by municipal law, through an expropriation proceeding, that terminating our concession prior to the contractual expiration date is in the public interest. If any municipality terminates our concession, we are entitled to be indemnified for the unamortized portion of our investments, but the compensation may not be sufficient for us to recover the full value of our investments. Further, under the terms of the Constitution of the State of São Paulo, we may receive the compensation over a term of 25 years. The early termination by municipalities of any of our concession contracts, or our inability to receive adequate compensation for the investments we made, or if compensation is paid over a term of 25 years, would have a material adverse effect on us.

In 1997, the municipality of Santos enacted a law expropriating our water and sewage systems in Santos. In 1995, the municipality of Diadema terminated the concession contract that had been entered into with us prior to the expiration of the agreement. There are pending legal proceedings discussing both the expropriation carried out by the municipality of Santos and early termination by the municipality of Diadema. We continue to provide water and sewage services to Santos and sell water on a wholesale basis to Diadema. For further information on these lawsuits, See *Item 8.A. Consolidated Statements and other Financial Information Legal Proceedings*.

We cannot assure you that other municipalities will not seek to terminate their concessions before the contractual expiration date. Exercise of concession termination rights by substantial numbers of municipalities could have a material adverse effect on us.

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Law No. 11,445/07, the new basic sanitation law, provides that the parties to new contracts have to establish the amount of the compensation in the agreement for the unamortized portion of the investment in case of termination of the agreement prior to the contractual expiration date. In the event there is no agreement between the parties for the unamortized portion of the investment to be repaid to the service provider in case of termination of the agreement prior to the contractual expiration date, the new law determines a default provision, i.e., the valuation of the investment by an independent expert based on the economic value or revaluation of the book value of the investment. This default provision of Law No. 11,445/07 may also be applicable to current concessions but in the absence of mutual agreements, the calculation of the indemnity is based on the terms and conditions of the previous agreement. In addition, we cannot anticipate the effects of this law on the amount of, and enforceability of the right to, compensation and how Brazilian courts will enforce the provisions of Law No. 11,445/07.

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

Our capital expenditure program requires substantial liquidity and capital resources of approximately R\$5.87 billion in the period from 2007 through 2010, of which we spent R\$ 921.1 million in 2007 and we expect to spend R\$1,574.0 million in 2008.

We have funded in the past, and we plan to continue to fund, these expenditures with funds generated by operations and domestic and foreign currency borrowings on acceptable terms. A significant portion of our financing needs have been funded by lenders controlled by the Federal Government. We also benefit from long-term financing from international multilateral agencies and development banks at attractive interest rates. Changes in the policies of the Federal Government regarding the financing of water and sewage services, or our failure to continue to benefit from long-term financing from domestic and international multilateral agencies and development banks at attractive interest rates may impair our ability to meet our obligations or finance our capital expenditure program and could have a material adverse effect on us.

As a general rule, financial institutions and other institutions authorized to provide credit by the Central Bank may only provide loans to public sector entities, such as us, up to a certain percentage of the entities' shareholders' equity. Because of these limitations on our ability to obtain credit from domestic financial institutions, our options for raising funds, other than the cash generated by our operations, consist mainly of borrowing from national and international financial institutions or development agencies and issuing debt securities in both the domestic and international capital markets. These legal limitations could adversely affect our ability to continue our capital expenditure program.

We are also subject to financial covenants limiting our ability to incur additional indebtedness, whether denominated in *reais* or foreign currency. Under these covenants, we would have been able to borrow up to an additional R\$3,329.8 million as of December 31, 2007. These contractual limitations may prevent us from completing our capital expenditure program, which could have a material adverse effect on us.

***We are subject to cost increases to conform to environmental requirements and potential environmental responsibilities***

Our facilities are subject to extensive Brazilian federal, state, local levels, regulatory laws, and environmental covenants relating to the protection of human health and the environment. We could be subject to civil public actions and criminal, administrative and other civil proceedings for non-compliance with environmental laws and regulations, which could expose us to civil penalties and criminal sanctions, such as fines, indemnification. Since environmental laws and their enforcement by Brazilian authorities are becoming more stringent, our capital expenditures and expenses for environmental compliance may increase substantially. We are a party to a number of civil public actions related to environmental matters, with regard to which we are unable to calculate our estimated amount of potential liability. For further information on these lawsuits, See *Item 8.A. Consolidated Statements and other Financial*

*Information Legal Proceedings.*

Civil lawsuits and inquiries involving environmental matters are in large part related to the discharge of untreated sewage into waterways and the disposal of sludge from water and sewage treatment stations. However, we are committed to fulfilling environmental obligations, seeking to work proactively and preventively. We have pledged to cooperate with oversight agencies and with the Public Prosecutors Office, with which it has established commitments and formalized the terms of our compliance.

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Our compliance requirements have been implemented with extreme technical and administrative rigor, aiming to conform with environmental requirements. Our compliance with the commitments arising from these agreements and instruments is provided for in the budget.

Given the need to periodically renew licenses and authorizations, We have been enhancing our management instruments used to monitor our operations and facilities in terms of our compliance with the technical requirements of the licenses and authorizations currently in force and the needs related to the regulatory compliance of the existing operational park. Environmental feasibility and compliance analyses are present in all phases of our new projects, including the conception, installation and operational phases.

***Due to pending cases in the Brazilian Supreme Court, there is potential instability in the legal framework with respect to which governmental authority has the right to plan and regulate basic sanitation services in metropolitan areas.***

We are aware of two lawsuits (Ações de Inconstitucionalidade: ADIN 1842-5 Rio de Janeiro and ADIN 2.077 -3 Bahia) pending in the Brazilian Supreme Court that involve constitutional issues related to the level of public governmental authority (states, municipalities or groups of municipalities) that has the right to plan and regulate basic sanitation services delivered in metropolitan areas, as well as the right to execute concession and program agreements.

Although the State of São Paulo is not party to either of these cases and the decisions in each of these cases will not bind the State of São Paulo, any municipality in the State of São Paulo or their contractual relations with us, the outcome will likely influence future decisions of state and federal courts in the State of São Paulo with respect to similar lawsuits.

We cannot assure you when the lawsuits will be determined nor do we know how we will be affected by the outcome of these lawsuits. If municipalities are granted the right to plan and regulate basic sanitation services in metropolitan areas, they may decide to hold public biddings or even provide basic sanitation services on their own instead of executing a concession or program agreement with us, in which case, we are likely to face a substantial increase in competition from other bidders and municipalities.

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

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, civil, environmental, tax, labor, condemnation and other proceedings. A substantial monetary judgment against us in one or more of these legal proceedings may have a material adverse effect on us. Based on advice from our lawyers, we have provisioned a total aggregate amount of R\$945.3 million as of December 31, 2007 to cover probable losses related to legal proceedings. However, this provision does not cover all legal proceedings involving monetary claims filed against us and it may be insufficient to cover our liabilities related to these claims. Any unfavorable judgment in relation to these proceedings may have an adverse effect on us. For more information, see *Item 8.A. Consolidated Statements and other Financial Information Legal Proceedings*.

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

***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 that trade in emerging markets, such as Brazil, often involves greater risk than investing in securities of issuers in the United States, and these investments are generally 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 in the United States. 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 in the United States. The ten largest companies in terms of market capitalization represented approximately 54.7% of the aggregate market capitalization of the Bovespa as of December 31, 2007. The top ten stocks in terms of trading volume accounted for approximately 51%, 46.4% and 45.8% of all shares traded on the Bovespa in 2005, 2006 and 2007 respectively.

***Restrictions on the movement of capital out of Brazil may impair the ability of holders to receive dividends and distributions on, and the proceeds of any sale of, the common shares underlying our ADSs.***

The Brazilian government may impose temporary restrictions on the conversion of Brazilian currency into foreign currencies and on the remittance to foreign investors of the proceeds of their investments in Brazil. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil's balance of payments or there are reasons to foresee a serious imbalance.

The Brazilian government imposed remittance restrictions in 1990. Similar restrictions, if imposed, would impair or prevent the conversion of dividends, distributions, or the proceeds from any sale of common shares, as the case may be, from *reais* into U.S. dollars and the remittance of the U.S. dollars abroad. We cannot assure you that the Brazilian government will not take similar measures in the future. In such a case, the depository for our ADSs will hold the *reais* it cannot convert for the account of the ADR holders who have not been paid. The depository will not invest the *reais* and it will not be liable for the interest.

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

The Brazilian custodian for the common shares underlying our ADSs must obtain a certificate of registration from the Central Bank to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to our common shares or upon the disposition of our common shares. If an ADR holder decides to exchange ADSs for the underlying common shares, this holder will be entitled to continue to rely for five business days from the date of exchange on the custodian's certificate of registration. After that period, 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 he or she obtains his or her own certificate of registration or register under Resolution No. 2,689, of January 26, 2000, of the Brazilian National Monetary Council, which entitles registered foreign investors to buy and sell on the Brazilian stock exchanges. If the holder does not obtain a certificate of registration or register under Resolution No. 2,689, this 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. We cannot assure you that the custodian's certificate of registration or any foreign capital registration obtained by a holder may not be affected by future legislative changes, or that additional restrictions applicable to the holder, the disposition of the underlying common shares or the repatriation of the proceeds from disposition will not 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 fixed assets and those of these other persons 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 difficulties 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 as payment of the judgment must be made pursuant to the State's budget in a subsequent fiscal year. None of the public property of our controlling shareholder is subject to seizure or attachment, either prior to or after judgment.

***The protections afforded to minority shareholders in Brazil are different from those in the United States and other jurisdictions and may be more difficult to enforce.***

Under Brazilian law, the protections afforded to minority shareholders are different from those in the United States and other jurisdictions. In particular, the case law with respect to shareholder disputes is less developed under Brazilian law than under US law and the laws of other jurisdictions and there are different procedural requirements for bringing shareholder lawsuits, such as shareholder derivative suits. As a result, in practice it may be more difficult for our minority shareholders to enforce their rights against us or our directors or controlling shareholder than it would be for shareholders of a non-Brazilian company.

***Actual or anticipated sales of a substantial number of our common shares could decrease the market prices of our common shares and ADSs.***

Sales of a substantial number of our common shares or the anticipation of such sales could decrease the trading price of our common shares and ADSs. As of December 31, 2007, we had 227,836,623 common shares outstanding, including 114,508,087 shares held by the State. As a consequence of the issuance of common shares or sales by the State or other existing shareholders, the market price of our common shares and, by extension, our ADSs may decrease significantly. As a result, a holder may not be able to sell his or her securities at or above the price he or she paid for them.

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

Under our by-laws, any disputes among us, our shareholders and our management with respect to the application of *Novo Mercado* rules, Brazilian Corporate Law and the application of the rules and regulations regarding Brazilian capital markets will be resolved by arbitration conducted pursuant to the São Paulo Stock Exchange Arbitration Rules in the São Paulo Stock Exchange Arbitration Chamber. Any disputes among shareholders, including ADR holders, and disputes between us and our shareholders, including ADR holders, will also be submitted to arbitration. The State is currently not permitted by law to sell its control shares. 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 by-laws. 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.

***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 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.

***A holder of our ADSs may find it more difficult than a holder of our common shares to exercise his or her voting rights at our shareholders meetings.***

Holders may exercise voting rights with respect to the common shares represented by our ADSs only in accordance with the deposit agreement relating to our ADSs. There are no provisions under Brazilian law or under our by-laws that limit the exercise by ADR holders of their voting rights through the depositary with respect to the underlying common shares. However, there are practical limitations upon the ability of ADR holders to exercise their voting rights due to the additional procedural steps involved in communicating with these holders. For example, our common shareholders will receive notice of shareholders meetings through publication of a notice in an official government publication in Brazil and will be able to exercise their voting rights by either attending the meeting in person or voting by proxy. ADR holders, by comparison, will not receive notice directly from us. Instead, in accordance with the deposit agreement, we will provide the notice to the depositary, which will, in turn, as soon as practicable thereafter mail to ADR holders the notice of the meeting and a statement as to the manner in which instructions may be given by holders, but only if we request the depositary to do so. To exercise their voting rights, ADR holders must then instruct the depositary as to voting the common shares represented by their ADSs. Due to these procedural steps involving the depositary, the process for exercising voting rights may take longer for ADR holders than for holders of common shares. ADSs for which the depositary fails to receive timely voting instructions will not be voted at any meeting.

## ITEM 4. INFORMATION ON THE COMPANY

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

Companhia de Saneamento Básico do Estado de São Paulo-SABESP is a *sociedade de economia mista*, a mixed capital company, incorporated on November 1, 1973, with limited liability of unlimited duration, duly organized and operating under Brazilian Corporate Law. 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. As set forth in Article 2 of our by-laws, our corporate purpose is to plan, provide and operate basic sanitation services throughout the territory of the State of São Paulo, and sell these services and the related benefits that directly or indirectly arise in connection with these services. Under Article 63 of Supplementary Law 1,025 of December 7, 2007, we were permitted to expand our operational scope geographically and to add new types of services related to environmental sanitation and energy. See *Item 4.B. Business Overview Public Consortia Law and Cooperation Agreements* .

We operate water and sewage systems in the State of São Paulo in which the City of São Paulo, Brazil's largest city, is located. According to the Brazilian Institute of Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*), or 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. We had net revenue from sales and services of R\$5,970.8 million (US\$3,370.9 million) and net income of R\$1,048.7 million (US\$592.0 million) for 2007. We had total assets of R\$18,663.4 million (US\$10,536.5 million) and shareholders' equity of R\$9,784.0 million (US\$5,523.6 million) as of December 31, 2007.

We provide 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. We also supply water on a wholesale basis to six municipalities in the São Paulo Metropolitan Region in which we do not operate water systems. For the year ended December 31, 2007, the São Paulo Metropolitan Region (including the municipalities to which we provide water on a wholesale basis) and the Regional Systems accounted for 75.8% and 24.2% of our gross revenue from sales and services, respectively.

As of December 31, 2007, we provided water services to approximately 23.0 million people, approximately 59% of the urban population of the State of São Paulo, with a universalization of Water Coverage through 62,318 kilometers of water pipes and mains to approximately 6.8 million water connections. As of December 31, 2007, we provided sewage services to approximately 18.9 million people through 40,608 kilometers of sewer lines to approximately 5.2 million sewage connections. In addition, we currently sell water on a wholesale basis to six municipalities with a total estimated population of approximately 3.2 million.

The State, our controlling shareholder, is required by our by-laws and State law to own at least one-half plus one of our common (voting) shares. The State currently owns 50.3% of our outstanding common shares. As a mixed capital company, we are an integral part of the governmental structure of the State. Our strategy and major policy decisions are formulated in conjunction with the State Secretariat for Sanitation and Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*) as part of the overall strategic planning for the State. The majority of the members of our board of directors and our board of executive officers are nominated by the State Council for Protection of Capitals of the State (*Conselho de Defesa de Capitais do Estado de São Paulo*), or CODEC, a State agency presided over by the Secretary of the State Treasury and reporting directly to the Governor.

In addition, our capital expenditure budget is subject to approval by the legislature of the State and is approved in conjunction with the budget of the State Secretariat for Sanitation and Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*) 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 Strengths**

We believe that our strong business position and future prospects relate to the following strengths:

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*Well-established business with significant size and scale.* We provide water services directly and through other public companies to approximately 26.2 million people (including the municipalities to which we provide water services on a wholesale basis), having a universalization of Water Coverage as of December 31, 2007, and sewage services to approximately 18.9 million people, having a Sewage Coverage Ratio of 79% as of December 31, 2007. From 2004 to 2007, our net revenue from sales and services has increased by an average of 10.8% per year.

*Operations in Brazil's most populous and wealthy state.* The State of São Paulo, part of the most developed and economically active region of Brazil, is the most populous state in Brazil, with an estimated population of 41.3 million as of December 31, 2007. The City of São Paulo had an estimated population of 10.9 million as of December 31, 2007, with 19.7 million inhabitants in the São Paulo Metropolitan Region. 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\$727.1 billion in 2005, representing approximately 34% of Brazil's total GDP. The State of São Paulo generates more revenues from water and sewage services than any other Brazilian state.

*High-quality operations.* We believe that we adhere to high standards of service and utilize the best available technology in the sanitation business to control the quality of the water captured, produced and distributed. All 16 of our water quality control laboratories operate in accordance with NBR ISO/IEC 17,025 with 12 of these 16 laboratories accredited by INMETRO (National Institute of Metrology, Standardization and Industrial Quality), thereby assuring the quality of the test results. Moreover, the 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.

*Access to low-cost and diverse sources of financing.* Our strong cash flow generation from operations and compliance with financial covenants place us in a privileged position in our industry to obtain low cost, long-term financing from Brazilian public banks and international multilateral agencies and development banks. In addition, we are not dependent upon one or few sources of financing. We benefit from various alternatives of funding available in the Brazilian and international markets for our working capital needs and our capital expenditure programs.

*Strong corporate governance practices.* In 2002, we joined the *Novo Mercado*, the highest corporate governance listing segment of the São Paulo Stock Exchange (*Bolsa de Valores de São Paulo - Bovespa*). We are committed to maintaining certain corporate governance practices and disclosure requirements in addition to those already required under Brazilian law. Sabesp has integrated, as of December 1<sup>st</sup>, 2007, the Bovespa Corporate Sustainability Index (ISE), being the only company from the sanitation sector to be part of this index, which reflects the performance of our actions representing its high level of commitment with sustainability and social responsibility. These corporate governance practices requires that we increase shareholders' rights and to enhance the quality of information provided to our shareholders.

*Expansion opportunities.* We had a Sewage Coverage Ratio of 79% as of December 31, 2007, and plan to increase this level to 84% by 2010 by adding over 791,700 sewage connections. In addition, there are municipalities in the State of São Paulo in which we currently do not operate water or sewage concessions or to which we currently supply water solely on a wholesale basis, which represent a total population of approximately 15.9 million. Our strong presence in the State and experience in providing water and sewage services place us in a privileged position to expand our Sewage Coverage Ratio in municipalities where we only provide water services and to expand our water and sewage services to municipalities where we are not yet operating, not only in the State of São Paulo but also in other states of Brazil and abroad.

**Our Strategy**



Our mission is to make public sanitation services universally available in the State of São Paulo and to provide quality services in both the national and international markets. To this end, our strategic objectives are based upon the guiding principles of growth, quality, universalization of water services, social, economic and environmental sustainability, as well as our political and institutional relationships. We seek to implement these guiding principles through the following strategies:

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*Continue to reduce operating costs and increase productivity and profitability.* We intend to continue our efforts to reduce operating costs and increase productivity and profitability. To this end, we plan to improve the management of our assets, as well as continue reducing our total salary and payroll expenses by decreasing the number of our employees, automating some of our operations, streamlining operational processes, implementing integrated planning and further investing in internal technological research and development. We are also continuing our efforts to improve our collection of overdue accounts receivable from municipalities to which we provide water on a wholesale basis, from the State and from other governmental entities. We are actively pursuing the overdue amounts and in some cases exploring opportunities to trade these amounts for rights and infrastructure to operate water and sewage systems.

*Ensure the quality and availability of our services in our existing service area.* Our goal is to maintain universal coverage of water services with a high standard of quality and availability. We intend to continue providing universal water services and meet population growth by adding 652,100 water connections by 2010 and to increase our Sewage Coverage Ratio to 84% by 2010. To ensure the quality and availability of our services, we also intend to improve customer relations by shortening response times for customer installations as well as through a focused public relations program to enhance our image. In addition, we are also developing short, medium and long-term marketing strategies, such as client segmentation and tailor-made solutions for each type of client, which we believe will help us increase our customers base.

*Maintain our operating geographic base and expand the scope of our business.* We intend to maintain our operating base through the execution of new agreements. To this end, we are also seeking to develop closer relationships with the municipal governments that we serve to increase customer loyalty and thereby increase our revenues. In addition, pursuant to article 63 of Supplementary Law 1,025, we were permitted to expand our business, including the possibility of providing urban rainwater management and drainage services, urban cleaning services and solid waste management services, in addition to authorizing the planning, operation and maintenance of energy production, storage, conservation and commercialization systems for internal use as well as for third parties. In addition, the new rules simplified the process of the expanding operations in Brazil and abroad, authorizing us to (i) participate in the controlling group or capital of other companies, (ii) create subsidiaries, which may associate with other companies as both majority or minority shareholders, (iii) form consortiums with Brazilian and foreign companies, including other state or municipal basic sanitation companies, as lead company or otherwise, with the objective of expanding operations, combining technologies and expanding investments in basic sanitation services.

*New business platform.* Sabesp Environmental Solutions program is a new business platform that has as its main objectives to gain customer fidelity and expand our large industrial, commercial and residential customer base. The products and services are aimed at big customers who want to benefit from our knowledge and technology in the sustainability, environmental preservation and water resource management fields.

*Continue to expand our existing service areas and provide our services in other municipalities.* Our goal is to expand our sewage collection and treatment services. A significant portion of our capital expenditure program, of approximately R\$5.87 billion between 2007 and 2010, is designed to achieve this goal. We also regularly explore the possibility of executing agreements for the provision of water and sewage services in municipalities of the State of São Paulo in which we currently have no operations or to which we currently supply water solely on a wholesale basis, representing a total population of approximately 15.9 million. We evaluate possible expansion opportunities in terms of proximity to our existing service areas to maximize return on investment and improve our financial performance. We also intend to study, and take advantage of, opportunities in other Brazilian states and in other countries to expand our services and increase our market share.

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*Continue to prudently manage our levels of indebtedness.* Our total financial indebtedness decreased by 11%, from R\$6,326.7 million in 2006 to R\$5,685.2 million in 2007. This drop was mainly due to the settlement of the 1<sup>st</sup> Series of our 6th debenture in the amount of R\$ 231.8 million and to the amortization of domestic financing installments. In addition, in the period, our total foreign denominated debt recorded a 15.6% drop, from R\$ 1,472.7 million to R\$ 1,242.3 million, as a result of the appreciation of the *real* versus the U.S. dollar and the amortization of international financing installments. Pursuant to our current capital expenditure program, we have budgeted investments in the amount of approximately R\$5.87 billion from 2007 through 2010. This capital expenditure program is most likely to involve an increase in overall indebtedness during the forthcoming years of projected investments.

*Improve operating efficiency and reduce water losses.* We seek to reduce both physical water losses and non-physical water losses. To obtain reductions that are more significant and more consistent over the long term, we began to structure based on the integration and expansion of our existing activities. The program is currently involved in planning and prioritizing measures to be taken at individual locations. These measures are prioritized in accordance with their location of application, with a focus on the municipalities and industries supplied that present the highest loss rates, with the objective of optimizing the application of resources. A fundamental aspect of this program is to make significant efforts to renew infrastructure in order to reduce physical water losses. We are also seeking to reduce physical water losses by continuing to shorten the average time for the detection and repair of leaks in the system, for which we are planning the implementation of measurement and control districts to improve operational management. We are also seeking to reduce non-physical water losses by upgrading and replacing inaccurate water meters and intensifying efforts involving irregularities in active and inactive connections.

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, in other Brazilian states and abroad and, at the same time, bolster our results of operations and our financial condition and enhance shareholder value.

### **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 is, according to IBGE, the most developed and economically active region of Brazil, and which includes the States of Minas Gerais, Espírito Santo and Rio de Janeiro. The State of São Paulo lies between the States of Rio de Janeiro and Minas Gerais to the north, the State of Paraná to the south, Mato Grosso do Sul to the west and the Atlantic Ocean to the east.

The State of São Paulo occupies 3.0% of Brazil's land mass and encompasses an area totaling approximately 96,000 square miles. According to the State of São Paulo Data System (*Fundação Sistema Estadual de Análises de Dados - SEADE*), the State of São Paulo had an estimated population as of December 31, 2007 of 41.3 million.

As of December 31, 2007, the City of São Paulo, the State of São Paulo's capital, had an estimated population of 10.9 million, with 19.7 million inhabitants in the greater São Paulo Metropolitan Region. The São Paulo Metropolitan Region encompasses 39 cities and is the second largest metropolitan area in the Americas and among the four largest metropolitan areas in the world, according to the United Nations' World Urbanization Prospects, 2000 Revision. The São Paulo Metropolitan Region accounted for approximately 48% of the population of the State of São Paulo as of December 31, 2007.

According to IBGE, in 2005, the most recent year for which this data is available, the GDP of the State of São Paulo was approximately R\$ 727.1 billion, representing approximately 34% of Brazil's total GDP, making it the largest economy of any state in Brazil, based on GDP. The State of São Paulo is the leading Brazilian state in terms of manufacturing and industrial activity, also according to IBGE, with a strong position in car manufacturing, pharmaceuticals, computer production, steel making and plastics, among others, as well as the leading position in the

banking and financial services industries. The State of São Paulo is the most important exporting 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 19th century, water and sewage services in the State of São Paulo were generally provided by private companies. In 1877, the Province of São Paulo granted a concession for the provision of water and sewage services to *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 the *Companhia Cantareira de Água e Esgotos* and formed the Office of Water and Sewers (*Repartição de Água e Esgotos*), a governmental 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 by the municipalities directly 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 undertake administration of public services, which are considered to be better managed by a decentralized administrative and financial structure.

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 *Companhia Metropolitana de Água de São Paulo*, or COMASP, which purpose was to provide potable water on a wholesale basis for public consumption in the municipalities making up 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 *Superintendência de Água e Esgoto da Capital*, or SAEC, was created by the State government to distribute water and collect sewage in the City of São Paulo. All assets previously owned by the Department of Water and Sewers in connection with these activities were transferred to SAEC. Also in 1970, the State created the *Companhia Metropolitana de Saneamento de São Paulo*, or SANESP, to provide sewage treatment services for the São Paulo Metropolitan Region. All assets previously owned by the Department of Water and Sewers in connection with those activities were transferred to SANESP. The Department of Water and Sewers was subsequently closed.

On June 29, 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*). 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 us. As set forth in Article 2 of our by-laws, our corporate purpose is to plan, provide and operate basic sanitation services throughout the territory of the State of São Paulo, and sell these services and the related benefits that directly or indirectly arise in connection with these services. Under Article 63 of Supplementary Law 1,025 of December 7, 2007, we were permitted to expand our operational scope geographically and by the addition of new types of services related to environmental sanitation and energy. See *Item 4.B. Business Overview – Public Consortia Law and Cooperation Agreements* .

## Corporate Organization

In 2004, we reorganized our corporate management structure. As a result, we currently have six management divisions, each of which is supervised by one of our executive officers.

The allocation of responsibilities among the executive officers is made by the board of directors, in accordance with the by-laws and following receipt of an initial proposal from the Chief Executive Officer. 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, performing the coordination, evaluation and control of all functions related to Chief Executive Officer's office and staff, strategic integrated planning, business management and organization corporate communication, audit, ombudsman, new businesses and concession negotiation. The executive officers report to the Chief Executive Officer are:

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- the Corporate Management Officer, who is responsible for marketing, human resources and quality control programs, legal affairs, information technology, asset management, legal and procurement, and contracts.
- the Chief Financial Officer and Investor Relations Officer, who is responsible for financial planning, raising and allocating financial resources to all divisions within the Company, conducting capital markets and other debt transactions and managing debt levels, control department, accounting, corporate governance and investor relations.
- the Planning and Technology Officer, who is responsible for the integrated technical planning, environmental planning and management, technological development, management and control of water quality and effluents, strategic maintenance, integrated project management and coordination and execution of special investment programs and projects.
- the Chief Operating Officer of the São Paulo Metropolitan Region Division, who is responsible for managing the distribution of water and collection of sewage for the São Paulo Metropolitan Region. The main function of the Chief Operating Officer of the São Paulo Metropolitan Region Division is planning, operating and maintaining the water and sewage systems and customer relation services in the metropolitan regions, the provision of wholesale water supply and sewage treatment, and the operational control of its division. The Chief Operating Officer of the São Paulo Metropolitan Region Division is also responsible for providing technical support to the autonomous municipalities, and intermediating and directly negotiating with local communities and municipalities in order to accommodate both the interests of the communities and our commercial interests.
- the Chief Operating Officer of the Regional Systems Division, who is responsible for managing the operation, maintenance, execution of planning and works for the water and sewage supply systems, sales and call center services, as well as the operational control of its division. The chief operating officer of the regional systems division is also responsible for sanitation advisory services to independent municipalities and for the mediation and the negotiation with communities and local governments, aiming at aligning our interests with the interests of our of 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 meet the growing demand for water and sewage services in the State of São Paulo. Our capital expenditure program has four specific goals in the municipalities we serve: (1) to continue to meet the maximum demand for treated water; (2) to expand the percentage of households connected to our sewage system; (3) to increase the treatment of sewage collected; and (4) to increase operating efficiency and reduce water losses.

From 1998 through 2007, our capital expenditure program totaled R\$7.3 billion, primarily to build up our infrastructure and for our efforts to reduce water losses. We have budgeted investments in the amount of approximately R\$5.87 billion from 2007 through 2010. We invested R\$678.2 million in 2005, R\$904.9 million in 2006 and R\$ 921.1 million in 2007.

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

	<b>Forecast Capital Expenditures</b>				
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2007-2010</b>
	<b>(in millions of reais)</b>				
Water	336	563	622	755	2,276
Sewage	487	907	824	814	3,032
Others	137	104	145	176	562
<b>Total</b>	<b>960</b>	<b>1,574</b>	<b>1,591</b>	<b>1,745</b>	<b>5,870</b>

Our capital expenditure program from 2007 through 2010 will continue to focus on achieving our targets by making regular investments and expanding our infrastructure as well as making investments in our program for the reduction of water losses throughout the 366 municipalities that we serve. The following is a description of the main projects in our capital expenditure program.

***Metropolitan System Investment Program******Metropolitan Water Program***

Demand for our water services has grown steadily over the years in the São Paulo Metropolitan Region and has exceeded at times the capacities of our water systems. As a result, prior to September 1998, certain part of our customers in this region received water only on alternate days of the week. We refer to this as rotation. In order to remedy this situation, we implemented the Metropolitan Water Project to improve regular water supply to the entire São Paulo Metropolitan Region. This program terminated in 2000 and the rotation was eliminated, but we have maintained our investment projections for the São Paulo Metropolitan Region. In 2005, 2006 and 2007, we invested R\$75.0 million, R\$53.0 million, and R\$130.9 million respectively, in this region.

***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. As a way of reversing the situation, the State of São Paulo created a recovery program designed to reduce pollution of the Tietê River by installing sewage collection lines along the banks of the Tietê River and its tributaries. These lines collect raw sewage and deliver it to our sewage



treatment facilities. We completed the first phase of the program during the years of 1992 and 1998.

In connection with the first phase of the Tietê Project, in June 1998, we completed the construction of three additional sewage treatment facilities and invested a total of US\$1.1 billion, of which US\$450.0 million was financed by the Inter-American Development Bank, US\$100.0 million was financed by Caixa Econômica Federal and US\$550.0 million was funded by us.

We are currently in the second phase of the Tietê Project, for which we budgeted for additional capital expenditures of approximately US\$500.0 million from 2000 through 2008, US\$200.0 million of which is financed by the Inter-American Development Bank. We have also entered into a loan agreement and an on-lending agreement with the Brazilian National Bank for Social and Economic Development (Banco Nacional de Desenvolvimento Econômico e Social), or BNDES, for R\$60.0 million and R\$180.0 million, respectively, to finance this second phase. As of December 31, 2007, we had invested US\$436.0 million in this phase of the Tietê Project.

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The main objective of this second phase is the continuity of the expansion and optimization of the sewage systems of the São Paulo Metropolitan Region, primarily focusing on actions that allow the destination of a higher volume of raw sewage to the sewage treatment facilities that were built in the first phase of the Tietê Project.

As part of the second phase of the Tietê Project, we implemented the geographic information system named SIGNOS. SIGNOS is a management information system which automates and integrates various business processes, including project management, maintenance, operations and customer service and maps out our entire municipal infrastructure in the São Paulo Metropolitan Region. In addition, this phase included the undertaking of a project aimed at evaluating and potentially revising our current tariff structure in order to cover the systems operation and maintenance costs and appropriately remunerate current and future investments. This project is also financed by our loan with the Inter-American Development Bank.

As of December 31, 2007, we owed US\$249.7 million to the Inter-American Development Bank for the financing it provided. For further information on the agreement entered into with the Inter-American Development Bank, see *Item 5.B. Operating and Financial Review and Prospects - Liquidity and Capital Resources Capital Sources*. We now provide secondary treatment to approximately 62% of the sewage collected in the São Paulo Metropolitan Region. 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 13 cubic meters of sewage per second. Currently, raw sewage is delivered to our secondary treatment facilities along the Tietê River and the Tamanduateí River before treated sewage is discharged into those rivers. We plan to build additional collection lines to direct more raw sewage to our treatment facilities.

*Alto Tietê Public Private Partnership (PPP)*

In June 2008 we entered into a Public Private Partnership, or PPP, with Cab Spat, a special purpose company whose main shareholders are Cab Ambiental and Galvão Engenharia. Cab Spat will be responsible for (i) expansion of Tiaçupeba Water Treatment Plant capacity from 10 cubic meters per second to 15 cubic meters per second, (ii) construction of 17.7 kilometers of water network and mains, (iii) construction of 4 water storage tanks with total capacity of 70,000 cubic meters, (iv) installation of boosters, and (v) construction of pumping stations. The total capital expenditure for these investments will amount to approximately R\$300 million. Cab Spat will also provide dams, civil works and electromechanical maintenance; operation services such as sludge treatment and complementary services of water transmission and supply. The total amount expected to be paid by us at the end of this 15 year contract is approximately R\$1.3 billion, including services and investments.

*Corporate Water Loss Reduction Program*

In the second semester of 2007 we started to structure a Corporate Water Loss Reduction Program, with a ten-year span. The aim of this program is to obtain more consistent and faster reduction of water losses, through the integration and expansion of our existing loss reduction programs and through the assuring of the availability of funds and technology.

*Water Source Program*

The objective of this program is the promotion of urban development and social inclusion to mitigate the pollution problems in all water reservoir systems of the São Paulo Metropolitan Region. In this program we will be responsible for the expansion of sewage systems, pre-treatment of streams and development of more sophisticated treatment facilities. We expect to launch this program in 2008 with the conclusion foreseen for 2013. The total expected investment of this program is US\$281.8 million and will be carried out with resources from the World Bank and participant matching funds. Our participation in this Program is US\$125.0 million.

*Clean Stream Program*

This program is a partnership between the State Government, through Sabesp, and the municipality of São Paulo, which aims at cleaning and revitalizing the main municipal streams in a two-year period, with investments of approximately R\$200 million. The aim of this program is the improvement of the sanitary sewage system and the clean-up of the surrounding area of streams, which will benefit approximately 2.4 million people. Of the 42 major streams selected in this first stage, 12 have already been cleaned. Our participation in this Program is approximately R\$177.0 million.

*Regional Systems Investment Programs*

We currently have a number of projects in progress and planned for the Regional Systems, including projects relating to abstraction of water and collection, removal and final disposal of sewage. We spent R\$222.0 million, R\$331.2 million and R\$381.3 million on these projects in 2005, 2006 and 2007, respectively, and we have budgeted for additional capital expenditures of approximately R\$2.4 billion from 2007 through 2010. Following are the major programs

*Environmental Recovery Program for the Baixada Santista Metropolitan Region      Programa Onda Limpa*

On August 6, 2004, we entered into a credit agreement with Japan Bank for International Cooperation, or JBIC, for the financing of the Environmental Recovery Program for the Baixada Santista Metropolitan Region, which was

guaranteed by the Federative Republic of Brazil, for a total amount of R\$382.8 million. For further information on the agreement entered into with the JBIC, see *Item 5.B. Operating and Financial Review and Prospects Liquidity and Capital Resources Capital Sources*. The total investment to be made with respect to this project for sewage systems is approximately R\$1.2 billion and the balance will be our responsibility, for which we will seek further financial support from local and international public banks and agencies. The first disbursements under this agreement began in August 2005 with the commencement of the management agreement. The construction works began in the second quarter of 2007. The main goals of this program are to improve and expand the water and sewage systems in the municipalities comprising the Santos Metropolitan Region. As of December 2007, the total disbursements for this program reached R\$57 million.

### *Mambu/Branco Water Production System*

This program seeks to increase and improve the Mambu/Branco Water Production System, which will make possible the expansion of water production to supply municipalities in the Southern Baixada Santista Region, increasing production by 1.0 m<sup>3</sup>/s and treatment by 1.6 m<sup>3</sup>/s. The total investment on the project is approximately R\$336.9 million, of which R\$241.2 million involves funds from Caixa Econômica Federal (CEF) and the remainder under the responsibility of Sabesp. Construction works of the project are expected to start in the second half of 2008.

## **Research and Development**

Our policy is to invest continually in the modernization of equipment and in the technology needed to identify, evaluate and improve our provision of basic sanitation services while promoting environmental protection and maintaining our competitiveness and profitability. Our research and development function is divided into committees according to strategy and complexity. In 2005, 2006 and 2007, we spent R\$4.7 million, R\$4.9 million and R\$3.4 million, respectively, on research and development. We have also partnered with several research institutions.

## **4.B. Business Overview**

### **Our Operations**

We provide water and sewage services to 366 municipalities in the State of São Paulo either under concession contracts or under another form of legal arrangement. We also provide water services on a wholesale basis.

Because of the enactment of new legislation regarding basic sanitation in Brazil, Law No. 11,445/07, we currently operate under two different contractual environments: (1) for the concession contracts that have already expired, we will negotiate a new contract model that follows the terms and conditions of the new legislation, and (2) for the concession contracts that have not expired, we will continue to operate under the terms and conditions of the previous concession contracts, except in circumstances where the new legislation is automatically applicable. For further information on this topic, see *The Basic Sanitation Law - Public Consortia Law and Cooperation Agreements*.

The new basic sanitation legislation, Law No. 11,445/07, establishes the date of December 31, 2010 as the deadline for water and sewage services companies, such as us, to establish a formal contract with municipalities with whom we do not currently have one in place.

### **Concessions**

Under the Brazilian Constitution, the authority to develop public water and sewage systems is shared by the states and municipalities, with the municipalities having primary responsibility for 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.

Under the terms of the new basic sanitation law, Law No. 11,445/07, existing concessions will remain in effect until payment of compensation is made based on the valuation of investments. The new law provides that our new concession contracts be planned, overseen 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.

At the end of 2007 we were a provider of water and sewage services to 366 municipalities, although, due to judicial orders, we had temporarily stopped operating three of them (Araçoiaba da Serra, Cajobi e Monte Alto). We have recently resumed providing service to Monte Alto. As for the other two municipalities (Araçoiaba da Serra and Cajobi) we are still in litigation. Even if we cannot resume providing services to these municipalities, there will be no major impact on us as: i) revenue from these operations account for less than 0.2% of our total revenues, and ii) we will continue to be entitled to indemnities related to the assets invested in these municipalities and not yet amortized.

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Substantially all of these concessions have 30-year terms. As of December 31, 2007, we had 106 program contracts in place. In December 2008, 104 concession contracts will expire or be under negotiation with the municipalities. Between 2009 and 2034, 117 concession contracts will expire. The remaining concession contracts have no expiration date. Some of the expired concession contracts have been extended for a short term while we negotiate the terms and conditions of the termination of the previous contract and the terms and conditions for the new contract. Despite the expiration of the contracts, we continue to provide water and sewage services to all municipalities.

In February 2006, we created a new division to manage the renewal of expiring concessions. The main responsibility of this division, which reports directly to the Chief Executive Officer, is to renew and thus maintain the existing base of municipalities that we currently operate and formalize contracts under the new model of associated management.

The current concessions are based on a standard form of contract between us and the relevant municipality. Each contract received the prior approval of the legislative council of each municipality. The principal terms of the concession contracts were as follows:

- We assume all responsibility for providing water and sewage services in the municipality;
- According to the municipal laws that authorized these concessions, we could collect the tariffs for our services without prior authorization of the municipality. The readjustment of our tariff will follow the parameters established by Federal Law No. 11,445/07 as well as the new state regulatory authority created ARSESP;
- The assets comprising the existing municipal water and sewage systems are transferred from the municipality to us. 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, assuming at least a 12.0% discount factor to us, from the concession being acquired. Payment is made in cash;
- As a general rule, to date we are exempt from municipal taxes, and no royalty is 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 mains and sewer lines; and
- Upon termination of the concession, or upon cancellation for any reason, we are required to return the assets comprising the municipality's water and sewage system to the municipality and the municipality is required to pay us the non-amortized book value of our assets relating to the concession.

Under concession contracts executed prior to 1998, the reimbursement for these 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 contract.

Concession contracts we have entered into since 1998 provide that after a period of 30 years from the commencement of the concession, the total value of the concession and assets will be 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 period, we are paid an amount equal to the present value of the cash-flow from the concession over the years remaining in the concession, using the

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same assumptions used to determine the value of the concession at its inception (adjusted for inflation).



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Following the enactment of the Concessions Law (Law No. 8,987/95) and of the Consortium Law (Law No. 11,107/05), the new contracts are adopting the new regime. This new regime gives municipalities a greater role and sets out more clearly the provision of services and the responsibilities of the parties. Therefore, all new contracts acquired by us and the new contracts to be executed after the expiration of the concessions will follow this new contract model. See *Government Regulation Public Consortia Law and Cooperation Agreements*.

Our new contract model follows the provisions of the newly enacted Law No. 11,445/07. The main contractual provisions are: joint execution of responsibilities related to planning, supervision and regulation of services, appointment of regulatory authority of services and periodic disclosure of accounts, among others.

Furthermore, the economic and financial equations in new contracts must be based on discounted cash flow methodology and on the reclassification of returnable assets as our own preexisting assets with any assets related to new investments considered in our possession, which may use and manage this asset.

According to Article 42 of the new basic sanitation law, 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 commercial operation of services, and these receivables may also be used as guarantees in funding operations.

Another important development was that the negotiations included exemptions from municipal taxes applicable on our operational areas and the possibility of the revaluation of our assets that existed prior to the applicable new contracts in cases involving the early resumption of services by the concession authority.

Municipalities have the inherent power under Brazilian law to terminate concessions prior to their contractual expiration dates for reasons of public interest. The municipalities of Diadema and Mauá, two municipalities we previously served, terminated our concessions in February 1995 and December 1995, respectively. The municipality of Diadema terminated our concession after asserting that we did not provide adequate water and sewage services, while the municipality of Mauá did so with our consent. However, we currently serve both municipalities through the sale of water on a wholesale basis.

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 as described above. We cannot be certain, however, that other municipalities will not seek to terminate their concessions in the future.

In addition, there is currently ongoing litigation with respect to municipalities that intend to expropriate our water and sewage systems or to terminate concession contracts prior to paying us any indemnification. For example, among others, we have pending proceedings with the municipalities of Santos, Sandovalina, Presidente Prudente and Itapira. For a detailed discussion on these proceedings, see *Item 8.A. Financial Information Consolidated Statements and other Information Legal Proceedings Other Legal Proceedings*.

***Operations in the São Paulo Metropolitan Region and in Other Metropolitan Regions***

We do not hold a formal concession to provide water and sewage services to the City of São Paulo, which accounts for 56.3% of our revenue, and to 36 other municipalities in the State of São Paulo. None of these other municipalities has a significant population, other than the municipality of Santos, which has a population of approximately 428,000. We believe that we have a vested and exclusive right to provide water and sewage services to the City of São Paulo and these other municipalities based, in some cases, upon a deed (*escritura pública*) and also, among other things, based on our ownership of the water and sewage systems serving the City of São Paulo and these other municipalities and certain succession rights resulting from the merger that formed us.

The new basic sanitation law, provides that, in case of termination of the relationship with the aforementioned municipalities with which we have not entered into a concession contract, an indemnification should be paid by the municipalities to us, in amounts to be calculated by studies and appraisals.

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On November 14, 2007, the Company and the Municipality of São Paulo entered into an Agreement to establish the conditions that ensure the stability in the provision, of water supply and sewage, and environmental utility services in the city of São Paulo, see note 23 to our financial statements.

***Wholesale Operations***

We provide wholesale water services to six municipalities, including the municipalities of Diadema and Mauá. In addition, until December 2003 we provided wholesale water services to the municipality of São Bernardo do Campo. In December 2003, we acquired water and sewage service assets in this municipality through the transfer of all related assets from the municipality to us. The amount paid for the purchase of assets was estimated by an economic-financial valuation report to be approximately R\$415.5 million, which included the liquidation of the water wholesale supply accumulated debt totaling approximately R\$265.4 million. The difference between the value of the assets and the accumulated debt was paid by us in cash to the municipality. Accordingly, we started providing water and sewage services to the municipality of São Bernardo do Campo beginning in January 2004.

***Execution of Sewage Services Agreements with Municipalities***

We provide wholesale sewage services to the municipalities of Mogi das Cruzes, Santo André, São Caetano, Mauá and Diadema. The negotiation of the agreement for the provision of wholesale sewage services with the municipality of Santo André had the intervention of the Public Prosecution Office, and in other municipalities it was a result of our efforts concerning the environment and the awareness of the municipal public authorities related to environmental issues. Through these agreements, in 2007 we treated about 2.9 million cubic meters of sewage per month from these municipalities. This is an example of our social-environmental responsibility and commitment. In 2007, the revenues from these services were approximately R\$8.0 million.

**Description of Our Activities**

As set forth in Article 2 of our by-laws, our corporate purpose is to plan, provide and operate basic sanitation services throughout the territory of the State of São Paulo, and sell these services and the related benefits that directly or indirectly arise in connection with these services. Under Article 63 of Supplementary Law 1,025 of December 7, 2007, we were permitted to expand our operational scope geographically and to add new types of services related to environmental sanitation and energy. *See Item 4.B. Business Overview Public Consortia Law and Cooperation Agreements* .

***Water Operations***

Our supply of water to our customers generally involves abstraction of water from various sources, subsequent treatment and distribution to customers premises. In 2007, we produced approximately 2,873.7 million cubic meters of water. The São Paulo Metropolitan Region currently is, and has historically been, our core market, accounting for approximately 72% of water invoiced by volume in 2007.

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>2005</b>	<b>2006</b>	<b>2007</b>
<b><i>Produced</i></b>	<b>(in millions of cubic meters)</b>		

São Paulo Metropolitan Region	2,088.9	2,134.8	2,115.0
Regional Systems	741.2	752.0	758.7
<b>Total</b>	<b>2,830.1</b>	<b>2,886.8</b>	<b>2,873.7</b>
<i>Invoiced</i>			
São Paulo Metropolitan Region	997.8	1,030.8	1,046.8
Wholesale	258.7	263.4	274.3
Regional Systems	502.4	513.0	525.9
<b>Total</b>	<b>1,758.9</b>	<b>1,807.2</b>	<b>1,847.0</b>

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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 Resources* *Water Losses*. In addition, we do not invoice:

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

The São Paulo Metropolitan Region experiences its highest levels of water demand during the summer months when water use increases. Water use generally decreases during the winter months. The summer months, when demand is highest, coincide with the rainy season, while the winter, when demand for water is lowest, corresponds to the dry season in the São Paulo Metropolitan Region. Demand within the Regional Systems will vary depending on the area; while the interior region experiences seasonality in demand similar to the São Paulo Metropolitan Region, the demand in the coastal region is chiefly a function of tourism, with the greatest demand occurring during the Brazilian summer holiday months.

The following table provides information on our revenues by geographic region:

	<b>Year ended December 31,</b>		
	<b>2005</b>	<b>2006</b>	<b>2007</b>
	<b>(in millions of reais)</b>		
São Paulo Metropolitan Region	4,044.2	4,534.1	4,888.1
Regional Systems	1,312.1	1,449.9	1,560.1
Total revenue from sales and services	5,356.3	5,984.0	6,448.2

***Water Resources***

We can abstract water only to the extent permitted by the State Department of Water and Energy and pursuant to authorization contracts entered into with it. Under some circumstances, depending on the geographic location of the relevant river basin or reservoir, the approval of the National Water Agency (*Agência Nacional de Águas*), or ANA, is also 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 flow from nearby rivers, or by a combination of these sources.

In order to supply water to the São Paulo Metropolitan Region, we rely on 20 reservoirs of non treated water and 182 reservoirs of treated water, which are located in the areas under the influence of the eight water producing systems which comprise the interconnected water system of the São Paulo Metropolitan Region. Resource availability, or volume of water available at the source for public distribution in these areas, is 71.6 cubic meters per second, due to the conclusion of the barriers of the Alto Tietê system. Total current capacity, or volume of water that can be treated from the interconnected water system of the São Paulo Metropolitan Region, is 67.0 cubic meters per second and has been designed to reach 75.2 cubic meters per second in 2009. Average verified production or volume treated during

2007 on the interconnected water system of the São Paulo Metropolitan Region was 65.7 cubic meters per second. The Cantareira, Guarapiranga and Alto Tietê systems, as a whole, supply approximately 83.9% of the water we produced for the São Paulo Metropolitan Region in 2007.

The Cantareira system accounts for approximately 47.2% of the water that we provided to the São Paulo Metropolitan Region (including the municipalities to which we provide water on a wholesale basis), which represented 75.8% of our operating revenue for 2007. The authorization (*outorga*) for the Cantareira system to use the water in the Piracicaba water basin was renewed on August 6, 2004 for a period of ten years.

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With respect to water usage, federal and state agencies are authorized to collect charges from entities, such as us, for the abstraction of water from, or dumping of sewage into, water resources. Since February 2004 we have been incurring expenses in connection with the use of water from the Paraíba do Sul River Basin and since January 2006 from the Piracicaba, Capivari and Jundiá River Basin. Our tariff readjustment formula takes into consideration the variation of expenses considered as non-administrable, which these expenses fall under. We expect to continue to be able to pass on these expenses to our customers. However, we are uncertain as to the likely charges that may be assessed in connection with the abstraction of water from or the dumping of sewage into other water resources that we use, or whether we will be able to continue to pass on the cost of all of these charges to our customers. For more information on water usage regulation, see *Water Usage*.

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

<b>System</b>	<b>Production rate<sup>(1)</sup> (in cubic meters per second)</b>
Cantareira	31.0
Guarapiranga	13.8
Alto Tietê	10.3
Rio Claro	3.8
Rio Grande (Billings reservoir)	4.8
Alto Cotia	1.0
Baixo Cotia	0.9
Ribeirão da Estiva	0.1
Total production rate	65.7

(1) Average of the twelve months ended December 31, 2007.

We own all of the reservoirs in our production systems other than the Guarapiranga and Billings reservoirs and a portion of some of the reservoirs of the Alto Tietê system, which is owned by other companies controlled by the State. We currently do not pay any charges with respect to the use of these reservoirs. In December 2001, we entered into an agreement with the State whereby the State, among other things, agreed to transfer the remaining reservoirs in the Alto Tietê system to us. However, the transfer of these reservoirs is currently being disputed and we are not certain whether this transfer will be legally allowed. See *Item 8.A. Financial Information Consolidated Statements and other Information Legal Proceedings Other Legal Proceedings*.

In the largest municipalities of the interior region, our principal source of water consists of surface water from nearby rivers. In the smaller municipalities of the interior region, we draw water primarily from wells. The coastal region is provided with water principally by surface water from rivers and mountain springs.

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 were able to meet the demand for water in the São Paulo Metropolitan Region, primarily as a result of our water conservation program, reductions in water loss, and the installation of new water connections. In 2006, we installed 156,139 new water connections and in 2007 we installed 173,739 new water connections.

The interconnected water system of the São Paulo Metropolitan Region services 30 municipalities, of which 24 are operated directly by us. We serve the other six municipalities on a wholesale basis, and the distribution is made by other companies or departments related to the relevant municipality.

In order to reach the final customer, the water is stored and transported through a complex and interconnected system comprising 31,136 kilometers of water mains and 182 reservoirs. This water system requires permanent operational supervision, engineering inspection, maintenance, quality monitoring and measurement control.

To ensure the continued provision of regular water supply in the São Paulo Metropolitan Region, we intend to invest R\$1.2 billion from the years 2007 until 2010 to increase our water production and distribution capacities as well as to improve the water supply systems. In 2007, total investment in water amounted to R\$288,6 million.

**Water Treatment.** We treat all water at our water treatment facilities prior to placing it into our water distribution network. We operate 198 treatment facilities, of which the eight largest, located in the São Paulo Metropolitan Region, account for approximately 72% of all water we produce. The type of treatment used depends on the nature of the source and quality of the untreated water. Water abstracted from rivers requires extensive treatment, while water drawn from groundwater sources requires less treatment. All water treated by us also receives fluoridation treatment.



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**Water Distribution.** We distribute through our own networks of water pipes and mains, ranging in size from 2.5 meters to 100 millimeters in diameter. Storage tanks and pumping stations regulate the volume of water flowing through the networks to maintain adequate pressure and continuous water supply. As of December 31, 2007, our water network contained 62,318 kilometers of water pipes and mains and 6.8 million water connections. The following table sets forth the total number of kilometers of water pipes in our network for the periods indicated.

	<b>As of December 31,</b>		
	<b>2005</b>	<b>2006</b>	<b>2007</b>
Water distribution pipes and mains (kilometers)	58,000	61,469	62,318
Number of connections (in thousands)	6,489	6,609	6,767

More than 90% of the water pipes in our water distribution network are made of cast iron or polyvinylchloride (PVC). Distribution pipes at customers' residences typically are made from high-density polyethylene tubing. Our water mains are mostly made of steel, cast iron or concrete.

As of December 31, 2007, our water distribution pipes and mains included:

- 31,136 kilometers in the São Paulo Metropolitan Region; and
- 31,182 kilometers in the Regional Systems.

We have 373 storage tanks in the São Paulo Metropolitan Region with a total capacity of 1.8 million cubic meters, and 1,650 storage tanks in the Regional Systems. We have 122 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 mains that require maintenance are cleaned and relined. 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 mains in the São Paulo Metropolitan Region generally to be adequate. Due to age, external factors such as traffic, the dense population and commercial and industrial development, water pipes and mains in the São Paulo Metropolitan Region are somewhat more susceptible to degradation than those in the Regional Systems. To counteract these effects, we have a maintenance program in place for water pipes and mains that is intended to deal with anticipated fractures and clogs due to brittleness and encrustation and to help ensure water quality.

We expect that new customers will be responsible for covering part of the costs of connecting to our water distribution network. Our water connection policy is to pay for the cost of installation of up to 15 meters of pipe from our distribution network to the point of connection, with the remainder paid by the customer. Thereafter, the customer must cover the costs of connecting to the network from the customer's residence, including costs of purchasing and installing the water meter and related labor costs. Industrial customers are responsible for the entire cost of connection. 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.

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The following table sets forth projected new water connections for the periods indicated.

	2007		2008	2009	2010	2007-2010
	Forecast	Actual	(in thousands)			
São Paulo Metropolitan Region	86.7	108.4	96.9	89.3	87.6	360.5
Regional Systems	62.1	65.3	70.0	75.0	84.4	291.6
Total System	148.8	173.7	166.9	164.3	172.0	652.1

**Water Losses.** The difference between the amount of water produced and the amount of water invoiced generally represents both physical and non-physical water losses. Water loss percentage represents the quotient of (1) the difference between (a) the total amount of water produced by us less (b) the total amount of water invoiced by us to customers minus (c) the volume of water set out below that we exclude from our calculation of water losses, divided by (2) the total amount of water produced by us. We exclude the following from our calculation of water losses: (1) water discharged for periodic maintenance of water mains and water storage tanks; (2) water supplied for municipal uses such as firefighting; (3) water we consume in our facilities; and (4) estimated water losses associated with water we supply to *favelas* (shantytowns).

Since 2005, we have established a new method of measuring our water losses, based on worldwide market practice for the sector. According to this new measurement method, average water losses are calculated by dividing (1) average annual water loss by (2) the average number of active water connections multiplied by 365. The result of this calculation is the liters of water lost per connection per day.

Using this calculation method, as of December 31, 2007, we experienced 553 liters/connections per day of water losses in the São Paulo Metropolitan Region and 339 liters/connections per day in the Regional Systems, averaging 467 liters/connections per day. We plan to reduce water losses in both regions to 420 liters/connections per day for the São Paulo Metropolitan Region and 284 liters/connections per day for the Regional Systems, which we expect will result in a total reduction to 364 liters/connections per day by 2010. Based on water loss percentage (see footnote 7 Item 3. A), we intend to reduce water losses from 29.8% to 24% in the São Paulo Metropolitan Region, and from 28.9% to 25% in the Regional Systems. In 2007, we experienced 29.5% in water losses and we expect to decrease the water losses to 24% in 2010.

Our strategy to reduce water loss will be carried out by a two-step process:

- reduction in the level of physical losses, which result mainly from leakage, primarily through the replacement and repair of water mains and pipes and installation of probing and other equipment, including strategically located pressure-regulating valves; and
- reduction of non-physical losses, which result primarily from the inaccuracy of our water meters installed at our customers' premises and at our water treatment facilities, and from clandestine and illegal use, through upgrading and replacing inaccurate water meters and expanding our personnel who work on anti-fraud actions.

We are taking measures to decrease physical losses by reducing response times for fixing leakages to less than 24 hours and by better monitoring non-visible water mains fractures. Among other measures we have adopted to reduce

physical water losses are:

- the introduction of technically advanced valves to regulate water pressure throughout the water mains to correspond to downstream consumption needs each day. 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 mains and the resulting stress on the network can cause significant water loss through cracks and an increase in ruptures of the pipes. The intelligent valves are equipped with probes programmed to feed data to the valve to reduce or increase pressure to the water mains as water usage fluctuates. As of December 31, 2007, we had installed 1,595 valves at strategic points in the network, with 985 valves installed in the São Paulo Metropolitan Region and 610 in the Regional Systems. We plan to install 142 additional valves by the end of 2008;

- the reconfiguration of interconnected water distribution to permit the distribution of water at lower pressure;
- the implementation of routine operational leak detection surveys in high water pressure areas in each case helping to reduce overall water losses;
- 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, are billed at a lower rate;
- fighting of fraud with the use of new, more sophisticated water meters that are more accurate and less prone to tampering;
- installation of water meters where none are present; and
- preventive maintenance of existing and newly installed water meters.

**Water Quality.** We believe that we supply high quality treated water that is consistent with standards set by Brazilian law, which requirements are similar to the standards set in the United States and Europe. Under a Health Ministry (*Ministério da Saúde*) regulation in Brazil, we have significant statutory obligations regarding the quality of treated water. These laws set certain standards that govern water quality.

In general, the State of São Paulo has excellent quality water from underground or superficial water sources. However, urbanization and disorganized occupation of some areas of the São Paulo Metropolitan Region ended up reducing the quantity of water in mains 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 also work to recover the quality of water of mains and invest in improvements of our treatment systems to guarantee the quality and availability of water in the next years.

Water quality is monitored in all stages of the distribution process, including at the water sources, water treatment facilities and on the distribution network. We have 15 regional laboratories, one central laboratory, and laboratories located in all water treatment facilities that monitor water quality and purity as required by standards set by us and as required by law, which employ approximately 300 technicians, biologists, engineers and chemists. Our laboratories perform an average of 130,000 analyses 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. All of our laboratories have obtained ISO 9001/2000 certification and twelve of our sixteen water control and quality laboratories have obtained a NBR ISO/IEC 17025 accreditation (General requirements for the competence of testing and calibration laboratories) awarded by INMETRO (National Institute of Metrology, Standardization and Industrial Quality).

All chemical products used for water treatment are analyzed and follow strict specifications set out in recommendations made by the National Sanitation Foundation, or NSF, and the Brazilian Association of Technical Rules (*Associação Brasileira de Normas Técnicas*), or ABNT and American Water Works Association (AWWA), to eliminate toxic substances that are harmful to human health.

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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 two fronts: (1) fighting algae growth at the water resource, resulting in our detection of no significant algae growth in 2007, and (2) using advanced treatment processes at the water treatment facilities, which involves the use of powdered activated carbon and oxidation by potassium permanganate. The algae growth creates significant additional costs because of the higher volumes of chemicals used to treat the raw 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 the pollution problem in all systems of the São Paulo Metropolitan Region. In addition, we also participate in the Clean Stream Program, a joint program with State Government, through us, and the Municipal of São Paulo to clean up important streams in this region. See *Capital Expenditure Program - Water Source Program and Clean Stream Program* .

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 have adopted a water fluoridation program which is designed to assist in the prevention of tooth decay among the population. Fluoridation primarily consists of adding fluorosilicic acid to water at 0.7 parts per million. We add fluoride to the water at our treatment facilities prior to its distribution into the water supply network.

### ***Sewage Operations***

We are responsible for the collection and removal of sewage through our sewage systems and for its subsequent disposal with or without prior treatment. As of December 31, 2007, we collected approximately 83% and 72% of all the sewage produced in the municipalities in which we operate in the São Paulo Metropolitan Region and the Regional Systems, respectively, accounting for approximately 79% of all the sewage produced in the municipalities in which we operated in the State of São Paulo during 2007.

**Sewage System.** The function of our sewage system is to collect, remove and dispose of sewage. As of December 31, 2007, we were responsible for the operation and maintenance of 40,608 kilometers of sewer lines, of which approximately 21,141 kilometers are located in the São Paulo Metropolitan Region and 19,467 kilometers are located in the Regional Systems.

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

	<b>As of December 31,</b>		
	<b>2005</b>	<b>2006</b>	<b>2007</b>
Sewage lines (kilometers)	37,181	39,126	40,608
Sewage connections (thousands)	4,878	5,002	5,167

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 sewer lines made of cast iron.

Industrial sewage has physical, chemical and/or biological characteristics that are qualitatively different from household effluents, and may eventually cause damage to or overload sewage collection and treatment systems, pose risks to the safety and health of operators and adversely affect the environment. To avoid such events, current environmental legislation establishes standards for the discharge of these effluents into the public sewage system. These standards are defined in Article 19 of State Decree 8,468 of September 8, 1976 and the related amendments. To ensure compliance with legislation, periodic audits are made of the sewage produced by all industrial clients and we also request self-monitoring reports from sewage-producing sources.

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The discharge of these effluents into the public sewage system is based on technical and administrative procedures. 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 the company and the effluent producer. Failure to comply with these conditions can lead to the suspension of the connection and notification of the environmental protection agency (CETESB) in order for the applicable measures to be taken. Effluents from our sewage treatment facilities (*Estações de Tratamento de Esgotos ETEs*) must comply with discharge standards established by federal and state regulations and also must comply with emission standards and observe the water quality of the bodies of water established by federal and state legislation. Emission standards consist of a set of parameters that must be verified before the effluents are discharged into a body of water. Quality standards are based on the classification of bodies of water, taking into account the expected use of the water, with these standards becoming more stringent for bodies of water with more important use profiles.

We consider the condition of the sewer lines in the São Paulo Metropolitan Region generally to be adequate. Due to greater volume of sewage collected and to higher population and commercial and industrial development, the condition of the sewer lines in the São Paulo Metropolitan Region is somewhat worse than that of the Regional Systems. To counteract the effects of deterioration, we maintain a continuing program for the maintenance of sewer lines intended to deal with anticipated fractures arising from obstructions caused by system overloads.

Unlike the São Paulo Metropolitan Region, the interior region does not generally suffer obstructions caused by sewage system overload. The coastal region, however, experiences obstructions in its sewer lines primarily due to infiltration of sand, especially during the rainy season in the summer months. In addition, the number of sewage connections in the coastal region is significantly lower than in the other regions served by us, with approximately 51% of all residences in the coastal region currently connected to our sewage network.

New sewage connections are made on substantially the same basis as connections to water lines: we assume the cost of installation for the first 15 meters of sewer lines from the sewage network to residential and commercial customers sewage connections and the customer is responsible for the remaining costs. Industrial customers are responsible for the entire cost of extension and connection to the sewage network.

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

	2007		2008	2009	2010	2007-2010
	Forecast	Actual	(in thousands)			
São Paulo Metropolitan Region	81.2	86.5	100.5	87.2	84.2	353.0
Regional Systems	58.9	65.0	63.9	82.4	233.4	438.6
Total	140.1	151.5	164.4	169.6	317.6	791.6

***Sewage Treatment and Disposal.*** In 2007, approximately 62% and 76% of the sewage we collected in the São Paulo Metropolitan Region and the Regional Systems respectively, or 66% of the sewage we collected in the State of São Paulo, was treated at our treatment facilities and afterwards discharged into receiving water bodies such as inland

waters and the Atlantic Ocean, in accordance with applicable legislation. Our sewage treatment facilities have a finite capacity. Flows in excess of this capacity are discharged directly, untreated, to inland waters and the Atlantic Ocean. Currently we operate 453 sewage treatment facilities and eight ocean outfalls.

The treatment consists of the removal of pollutants from sewage. The method to be used depends upon the physical, chemical and biological characteristics of the wastewater.

In the Metropolitan Region of São Paulo, the treatment used in the large treatment facilities is activated sludge, where there is a liquid phase and a solid phase which involves the sludge.

The activated sludge process was developed in England in 1914. It is widely used for the treatment of domestic and industrial sewage. The work consists of a system in which a biological mass grows, forms flakes, is continually recirculated and put in contact with organic matter, always with the presence of oxygen (aerobic).



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The activated sludge process is strictly biological and aerobic, in which the raw sewage and the activated sludge are intimately mixed, agitated and aerated in units known as secondary decanters where the solid part is separated from the treated wastewater. The settled sludge returns to the aeration tank or is removed for specific treatment.

We operate 47 activated sewage treatment facilities, each of which also contains a primary treatment facility. The five largest activated sewage treatment facilities located in the São Paulo Metropolitan Region have treatment capacity of approximately 18 cubic meters of sewage per second.

Sewage treatment in the Regional Systems will vary according to the particularities of each area. In the interior region, treatment consists largely of stabilization ponds where the organic matter is treated and discharged to receiving waters. There are 366 secondary treatment facilities in the interior region which have treatment capacity of approximately 10.5 cubic meters of sewage per second.

The majority of sewage collected in the coastal region receives treatment and disinfection and is then discharged into rivers and into the Atlantic Ocean. We have 67 sewage treatment facilities in the coastal region.

Our trunk lines are currently not sufficiently extensive to transport all sewage collected by us to our treatment facilities. As a result, a portion of the sewage collected by us is released untreated into receiving waters, resulting in high levels of pollution in these bodies of water. We are a party to a number of legal proceedings related to environmental matters. See *Item 8.A. Financial Information Consolidated Statements and other Information Legal Proceedings*. In addition, our capital expenditure program includes projects to increase the amount of sewage that we treat. See *Capital Expenditure Program and Government Regulation Sewage Requirements*.

**Sludge Disposal.** Sludge removed from the primary and secondary treatment processes typically contains water and a very small proportion of solids. We use filter presses, belt presses and centrifugation machines to abstract the water from the sludge. In 2007, we produced approximately 49,291 tons of sludge-dry base, of which 44,491 tons were discharged into landfills and the remainder was used for agricultural purposes. In addition, we are testing new technologies for sludge disposal as fertilizer in forest projects, fuel development and concrete manufacturing.

## Customers

We currently operate water and sewage systems in 366 of the 645 municipalities in the State of São Paulo. In addition, we currently sell water on a wholesale basis to six municipalities with a total population of approximately 3.2 million. The following table provides a breakdown of total revenues by geographic market for the periods indicated.

	<b>Year ended December 31,</b>		
	<b>2005</b>	<b>2006</b>	<b>2007</b>
	<b>(in millions of reais)</b>		
São Paulo Metropolitan Region	4,044.2	4,534.1	4,888.1
Regional Systems	1,312.1	1,449.9	1,560.1
Total revenue from sales and services	5,356.3	5,984.0	6,448.2

## Competition

We believe there are at least two reasons behind a possible increase in our participation in the domestic sanitation market. There are 274 municipalities in the State of São Paulo that operate their own water and sewage systems and that collectively have a population of approximately 12.6 million, or approximately 31% of the population of the State of São Paulo, excluding the population of the municipalities to which we provide water services on a wholesale basis. In addition,