

## Q3 2016 Earnings Call

### Company Participants

- Mário Azevedo de Arruda Sampaio, Head-Capital Markets & Investor Relations

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to SABESP's Conference Call to discuss its results for the third quarter of 2016. The audio for this conference is being broadcast simultaneously through the internet in the website [www.sabesp.com.br](http://www.sabesp.com.br). In that same address, you can also find the slideshow presentation available for download.

We inform that all participants will only be able to listen to the conference during the company's presentation. After the company's remarks are over, there will be a Q&A period. At that time, further instructions will be given. Please note this event is being recorded.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of SABESP's management and on information currently available to the company.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of SABESP and could cause results to differ materially from those expressed in such forward-looking statements.

Today with us we have Mr. Rui Affonso, Chief Financial Officer and Investor Relations Officer; Mr. Mário Arruda Sampaio, Head of Capital Markets and Investor Relations; and Mr. Marcelo Miyagui, Head of Accounting.

Now, I'll turn the conference over to Mr. Arruda Sampaio. Sir, you may begin your conference.

### Mário Azevedo de Arruda Sampaio

Okay. Good morning, everybody. Thank you for attending this conference call. We will discuss third quarter 2016 numbers, the water situation in the São Paulo Metro Region, company's investments in water supply and security in the Metro Region in São Paulo, as

well as other issues of interest that – to our shareholders and investors. This is a semi-slide presentation; at the end, we will move to the question-and-answer session.

Let's start on slide 3. Here, we showed the company's billed water and sewage volume, which was up by 4.7% in the third quarter of 2016 with an increase of 4.5% in water and 4.9% in sewage; all this compared to third quarter 2015.

This quarter follow the trends observed last quarter, and those volume continue to grow, and we show the billed volume evolution behavior since 2013 also. Here, we can see a significant downturn driven by the water crisis beginning second quarter 2014, up until second quarter of 2015, and from there a recovery of volumes, although as you can see below levels pre-crisis. With increased water availability and demand, production volume increased 9.1% in second quarter – in the quarter-over-quarter period and 9.4% in the year-over-year.

Let's move to slide 4, let's discuss our financial results. Net operating increased 17.2% over the same period last year, this is chiefly due to the 8.4% tariff increase effective as of May this year. The end of the bonus program and the contingency tariff at the beginning of the year has no impact now on this quarter when compared to the third quarter of 2015 when the amounts of bonus granted then was BRL 248 million, this value partly offset by BRL 144 million obtained from the contingency tariffs and what we mentioned, the 4.7% upturn in total billed volume and again 4.5% of which in water and 4.9% in sewage. All this and plus the positive effects of this volume increase in average tariff.

Cost and selling administrative and construction expense was increased 4.9% in the period, which in real terms represents a decrease given inflation in the period. Adjusted EBITDA increased 48.1% to BRL 1.33 billion from BRL 903 million in the same period last quarter in 2015. The EBITDA for the last 12 months went from BRL 3.5 billion to BRL 4.3 billion this quarter. The adjusted EBITDA margin came to 35.7% this quarter against 28.3% third quarter 2015. If we exclude revenues and construction costs, the adjusted EBITDA margin was 49.6% this quarter versus 40.4% third quarter 2015. Net income totaled BRL 573.9 million versus a net loss of BRL 580 million in 2015, third quarter 2015.

Now, on slide 5, let's go through the main variations in cost in relation to offset to third quarter 2015. In comparison with this fourth quarter last year, construction cost and expenses increased as we mentioned, 4.9%. Now, if we exclude construction cost, cost expenses declined 2.8%. The main items that increase were general expenses, 72.5% up; services, 17% up; and general supply, 8.6% up.

It's also worth noting the decline of BRL 259.7 million in payroll benefit and pension plan obligations. The main impact responsible for this decrease was a migration of 3,572 participants of a defined benefit plan that we called G1 to the defined contribution plan now called SABESPREV Mais which generated an early reduction of the actuarial deficit in the amount of BRL 334.2 million, an amount that was partially offset by the extraordinary contribution and incentives paid by SABESP to those who migrated in the amount of BRL 26.8 million. In net terms, the impact of the migration was BRL 307.4 million. All the details and explanations, you can refer to our earnings release.

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So, let's move now to slide 6. Here, we present quickly the main variations between third quarter 2015 and third quarter 2016 in the items that affected our net income which totaled BRL 573.9 million. Net operating revenue increased BRL 548.8 million or 17.2%. Cost and expenses including construction cost increased BRL 125.2 million or 4.9%. Other operating revenues and expenses recorded a negative variation of BRL 46.2 million. Net financial expenses and monetary restatements and exchange variations had a positive variation of BRL 1,362 million due to the lower appreciation of the dollars against the real and the yen of 1.1% and 2.7% respectively in this quarter when compared with the appreciation also of 28.1% and 30.5% also respectively in the third quarter 2015. Finally, income tax and social contribution increased BRL 586 million due to the higher taxable income between third quarter last year and third quarter this year.

Now, let's move to slide 7. We will comment on the current and general situation of the reservoirs that supply the São Paulo Metro Region compared now with 2015, 2014 and 2013. As we already mentioned in previous conference call, in the rainy season which began in October 2015 and then at March 2016, rainfall and water inflow returned to the average expected for the period, increasing the levels of the reservoir that supply the São Paulo Metro Region.

Between April and September this year, water inflow was 27% higher than in the same period last year as was water withdrawal, with a 10% increase. So we did increase water withdrawal.

The current available water volume in the Sao Paolo Metro Region is equivalent to the available water volume in mid-November 2013. Now, if we take into account the technical reserve volume, today's volume is equivalent to the beginning of September 2012. In other words, the available water volume in October 16 is greater than the recorded in the same month for the two years prior for the water crisis.

Due to this improvement, the Cantareira System has been gradually reincorporated and growing the population directly supplied which before the water crisis reached 9 million. Today the population served by this system is 7.4 million. When at the peak of the water crisis, this figure reached a low of 5.4 million. Really worth remembering that during the water crisis, the Guarapiranga and the Alto Tietê systems were responsible for supplying part of the population that was previously supplied by the Cantareira System.

As for the volume stored in these two reservoirs, in October 2016 there was a 350 billion liters of water compared to the 292 billion liters of water in October 2012, and to the 395 million liters of water in October 2013. Now, on November 3 this year, the reservoirs of the São Paulo Metro Regions stored altogether including technical reserve, 1.168 trillion liters versus 496 billion liters in the same date in 2015 and 317 billion liters in 2014.

So, clearly this scenario indicates that the water crisis is over and that the water currently available in the reservoirs is enough to securely supply the population. This belief is reinforced by the fact that we are at the beginning of the rainy season and key investments in water security are expected to be in place throughout (sic) [2017] (12:35) as we will comment later on.

We would also like to mention that rainfall in the Cantareira system in October was 30% higher than the historical average in the year through. Today, rainfall amounted to 57.2 millimeters and the historical average expected for the month is 161 millimeters.

Let's move on to slide 8. Here, we will talk about the investments we have been undertaking in order to expand water storage and production capacity and, therefore, increase water security in the Metro Region of São Paulo.

In 2017, we will conclude the two main projects related to water supply for the region. One of them is the São Lourenço Production System and the second is the interconnection between the Jaguari reservoir in the Paraíba do Sul River Basin and the Atibainha reservoir which is part of the Cantareira systems. These two investments alone will add 11.8 cubic meters per second of water availability to the Metro Region. If we consider that the average production in 2013 was 69.1 cubic meters per second and that this number fell to 52 cubic meters per second in 2015, that is a difference of 17.1 cubic meters, the volume of water availability that will be added by these two investments represent approximately 69% of the water availability shortfall and consequently production during the water crisis.

The works at the São Lourenço Production System are 54% complete. This project represents an investment of over BRL 2.2 billion during its construction period. Since all the construction work is carried out and funded by a private partner hired under a PPP contract, there is no impact on our cash flow.

Regarding the project to interconnect the Jaguari and the Atibainha reservoir, 90% of the project was completed by the end of the September and the expectation is to reach 53% by the end of this year.

Let's move to slide 9. On October 28 SABESP, EMAE, which is the metropolitan and energy company, energy company though listed in the Bovespa. So it's a listed company and controlled by the state of São Paulo. We entered then into an agreement with them and to fully and completely settle (15:32) and arbitration disputes involving both parties over the use of SABESP - by SABESP of water from the Guarapiranga and Billings reservoirs and alleged cost incurred, and to be incurred, with the operation, maintenance and monitoring of these reservoirs.

First, it is important to note that the effectiveness of this transaction is subject to a condition precedent which is the approval by each company's respective corporate bodies. In the case of SABESP, its board; and in the case of EMAE, its board plus shareholders through a extra - on an extraordinary shareholder meeting as well as Brazil's national electric power agency, ANEEL. As informed in the notice to the market issued by us yesterday, our board approved the agreement. As for EMAE, they have already obtained board approval to the agreement as informed in the notice to the market issued by them the day before yesterday on November - before that on November 8. But still on their side, there's a pending shareholder approval.

Under the agreement, SABESP will pay to EMAE the following amounts, BRL 6.6 million annually from October 2017 to October 2042 or as long SABESP and EMAE concessions

are valid; and BRL 46.270 million in five annual and successive installments, the first one being BRL 9.254 million in April 2017 and the remaining BRL 4 million, a weaker amount, maturing in April of the subsequent year. And all of these amounts being adjusted by the (17:25) up to the date of disbursement.

The celebration of the agreement was guided by the following assumptions: SABESP payments will not exceed the amount necessary to reimburse EMAE for the maintenance and operation cost of the Guarapiranga and Billings reservoir in the proportion to the amount of water extracted by SABESP in relation to the natural water inflow for each of this natural water, and payments will occur during only the duration of SABESP EMEA concession, and last SABESP shall request to assess our regulatory agency to incorporate this cost on to the ongoing tariff review process. Now, for more details on the agreement, we like everyone to access the material fact and the technical note related to this subject, and that is available on our website.

Well, we have other highlights which are not on the slide, and so we would like to comment. First is the full disbursement in October 28, I think was that, yes, of a \$150 million loan. This loan has a three-year maturity at an interest rate corresponding to the LIBOR - three-month LIBOR plus 4.5% per year with interest paid on a quarterly basis and amortization in six-month installment as of the 18th month. The proceeds of the loan were used to settle the 2016 Eurobond in the amount of \$140 million due in November 3rd. So, this is all done.

Another highlight is the improvement of SABESP's total debt over the EBITDA multiple which stood at 2.73 times this quarter. Please note that this figure was 3 times last quarter, that is second quarter this year, and 3.554 (19:31) times in third quarter 2015 and also remembering that our covenant limit is 3.65. And again, this is total debt - gross debt.

As for the tariff review process, a quick update. Recently, we received and have already complied to an official letter from ARSESP requesting the physical and monetary database and historical series for the period of the first tariff cycle, in such to review and balance out the actual figures to those of the first cycle business. So, this is already a kick-off in the discussion for the business plan and overall, the ratio (20:15).

But in addition to that we're also monitoring the ARSESP's bidding process, to hire consultants and advisors of this necessary event to carry out the revision process. The bidding process was at first suspended due to a challenge to procedures. But this was resumed on this Monday, on November 7, with the disclosure of the revised bidding document and the final bidding date expected to occur next week.

So, these were our remarks. Now we will begin our question-and-answer session.

## Q&A

### Operator

We will now begin our question-and-answer session. There appears to be no questions at this time, so I'll turn the conference back over to SABESP for their final remarks.

## A - Mário Azevedo de Arruda Sampaio

Okay, everybody. Thank you. But if you do have a question, feel free to call us later on, okay? Goodbye. See you next quarter.

## Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.

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