

## Q2 2011 Earnings Call

### Company Participants

- Mario Arruda Sampaio, Head of Capital Market and Investor Relations

### Other Participants

- Chris Newman, Analyst

### Presentation

#### Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to SABESP's conference call to discuss its results for the Second Quarter of 2011. The audio for this conference is being broadcast simultaneously through the internet at the Website [www.SABESP.com.br](http://www.SABESP.com.br). At that same address, you can also find the slideshow presentation available for download. (Operator Instructions)

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. Mario Arruda Sampaio, Head of Capital Market and Investor Relations; and Ms. Nara Maria Marcondes Franca, Head of Accounting.

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

#### Mario Arruda Sampaio

Okay. Thank you. Good afternoon, everybody. We have one more conference call to discuss the results for the quarter. We have five slides to overview.

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Let's start on slide 3. Here we present water and sewage billed volume, which was 3.1% higher in the Second Quarter of 2011 compared to the same period in 2010, with the billed volume increasing across all consumption categories. For the six-month period, the increase was 3% compared to the same period in 2010. The billed volume growth for the quarter was due to the increase in the number of connections and increase in industrial consumption, mostly coming from stronger economic growth.

With regard to water volume, overall volume for the Company, and this is a very frequent question we have received from investors and analysts, mostly on consumption per capita trend, there's some interesting data that we would like to share with you.

SABESP's domestic, internal data shows that average consumption in the metro region of Sao Paulo fell 14.3% in the last ten years. In 2001, households consumed an average of 17,080 liters of water per month. By this year, this number dropped to 14,650 liters. This reduction has resulted in monthly savings of 13.4 billion liters of water, and, at present, the metropolitan region of Sao Paulo consumes 80.4 billion liters of water a month. If we had -  
- If we continued with the 2001 average, monthly consumption would be 93.9 billion liters.

Just to give you an idea of the scales of the saving, these 13.4 billion liters are sufficient to cover a population of 2.9 million, or close to 30% of the city of Sao Paulo's current population. Four factors explain these savings -- awareness among the population thanks to SABESP's campaign on reducing water consumption, environmental overall education, reduction in water losses at the supply network, and improvements to the equipment, which now spends less water, and also the decline in the number of inhabitants per household. Note that SABESP once more has been holding campaigns for the rational use of water since the late 1990s, and this has helped change the habits of this population.

Also worth pointing out is the decline in the number of inhabitants per household, as I mentioned, in the same period. According to 2000 population census, there was -- there were 3.54 people per household in the metro region of Sao Paulo. And by the end of 2010, the average had dropped to 3.2 people.

We highlight that a significantly and important effect of the reduction in average consumption of water in the metro region of Sao Paulo is the postponement of additional capacity investments, given that any increase in production involves heavy, capital-intensive expenditures with production facilities, reservoirs, and equipment to transport this huge volume of water and sewage. This is especially critical in the metro region of Sao Paulo, where water availability is very -- extremely scarce and approximately ten times less than the minimum recommended by United Nations on a per capital basis.

So we would like to share that information with you.

To move on, let's comment on the water loss ratio of around 26% at the end of Second Quarter 2011. It is above Second Quarter 2010 but below First Quarter 2011. This is due to the fact that this number is calculated considering a moving average over the past 12 months. And for this reason, it is still affected by the discontinuance of the outsourced

water supply network maintenance services that we observed in 2010 for the metro region of Sao Paulo and that we have already mentioned in previous calls.

Let's move on to slide 4. We will comment on our financial results. Net revenue was positively affected by the tariff increase of 4.05% in September 2010 and the 3.1% increase in billed volume, as mentioned in the previous slide. Gross operating revenue that includes only water and sewage services grew by 6.5% quarter over quarter, while net operating revenue that includes also construction revenue grew 3%, mostly due to a decrease with construction revenue of 8.1%. This is giving lower investments in the period.

Other costs and expenses increased 4.2% in the period. As a percentage of net revenue, costs and expenses increased 73.4% Second Quarter to 74.3% in Second Quarter 2011.

EBITDA increased from BRL752.5 million in Second Quarter 2010 to BRL775.4 million this Second Quarter 2011, which represents an increase of 3%. As for EBITDA margin, as you can see, it remained stable at 33.1%.

So let's continue here. Net income increased BRL319.5 million in Second Quarter to BRL479.6 million in Second Quarter 2011, an increase of 50.1%. It is worth noting that this 50.1% variation in net income was impacted by the following three -- mostly by the following three nonrecurring items. First, in 2010, credit write-offs were BRL55 million higher than in 2011. Second, revenue from payments by the state of Sao Paulo, due to the adherence by SABESP to the exclusivity agreement with Banco Nossa Caixa and Banco do Brasil related to the rights on SABESP's employee payroll account, which will be valid between March 2007 and March 2014, with a total value of BRL63 million, which we have already recognized this quarter BRL47 million. The third would be exchange variance of BRL74 million in 2011 due to the real appreciation.

We note that, very important, if these factors were excluded, net income would have increased by 9.8%, still a very good increase.

Let's move to the next slide and talk about costs. We discuss here the main variations in costs in relation to the same period last year. In comparison with the Second Quarter of 2010, costs and expenses increased 4.2% this quarter, mainly affected by the 336.1% in general expenses, 15.8% increase in materials, 18.5% increase in depreciation and amortization, 44.7% decrease in credit write-offs, and a mere 4.1% increase in payroll and benefits.

As for general expenses that increased by BRL121 million, or 336%, this was mainly due to the transfer to the municipal fund of BRL7.6 million in the quarter for the agreement with the city of Sao Paulo, which, again, corresponds to 7.5% of the city's gross revenue, net of Cofins and Pasep. This occurred, obviously, for the quarter. In addition to this, also, an increase in the provision for legal contingencies in relation to the Second Quarter of 2010 in the amount of BRL46.9 million.

The 15.8% increase in expenses with treatment material was due to price adjustment and a change in the mix of chemicals utilized with the replacement of aluminum sulfate with

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aluminum polychloride, which is more appropriate for treating intensive water volumes. In this quarter, we had to utilize more intensively some water production facilities than others, and that pretty much provoked the need to change the mix of chemicals.

The 18.5% increase in depreciation and amortization is mostly due to the amortization terms adjustments between the asset's useful life and the terms of the agreement, whichever is the shorter.

Talking about credit write-offs, the drop of BRL34.8 million, or 44.7% -- this was mainly due to the additional provision in Second Quarter 2010 for debt with the municipal government of Sao Paulo.

We also wish to highlight the mild increase of 4.1% in payroll and benefits. As you all know, we announced an employee termination plan in First Quarter 2009. Now we are ready -- We already can see the benefits reaping from this. At the end of December 2008, we had 16,649 employees, and today we have 15,397 employees; as you can see, a reduction of 1,252 people. Between January and July 2011, we had 236 employees terminated, and another 133 should be terminated between August and December. Next year, we expect to dismiss 162 and finalize all the dismissals related to this program in 2013 with an additional 155 dismissals.

On the other side, we have already incorporated -- that is, hired all the replacement manpower of approximately 1,450 new employees.

Let's move to slide 6. Here we present the main variations and the items that affected our net income of BRL479.6 million. Net operating revenue increased by BRL67.3 million, or 3%, over the same period in 2010. Costs and expenses increased by BRL70.7 million, or 4.2%, higher than revenue growth. Other operating revenues, net of expenses, increased BRL46.8 million, mainly due to the signing of the employee payroll account exclusivity rights agreement with Nossa Caixa and Banco do Brasil for the period of March 2007 and March 2014.

Financial revenues and expenses impacted positively net income by BRL165.6 million. This variation was mainly due to the foreign exchange effect caused by the 4.2% depreciation of the dollar in the Second Quarter of 2011 compared to the 1.2% appreciation in Second Quarter 2010.

As for financial expenses, the reduction is explained by lower interest expenses on domestic loans and financing in the amount of BRL25.5 million in comparison with Second Quarter 2010 and mostly due to the amortization of the eighth debenture issued now in June 2011. Also, we can explain by a reduced need for a provision for interest on losses.

Now let's move to our last slide. Finally, we would like to inform you that, on August 9, Sao Paulo state sanitation and energy regulatory agency assessed authorized tariff adjustments of 6.83%, which is 0.04% below inflation, to be applied on a liter basis to all categories of water and sewage to consumers as of September 11, 2011. As you can see on the slide, tariff adjustments have been below inflation since 2008, not because this is

the year ARSESP began control of tariffs but exclusively to a company initiative launched in early 2007 to reduce costs through a corporate-wide water loss and energy cost reduction program that is ongoing.

Company expectation was and is that the regulatory agency would quickly put out methodologies such as for us to capture the productivity gains -- that these costs fall into the Part A full-pass-through components of the formula. Unfortunately, as we all know, ARSESP has been delaying the implementation of the new methodology, negatively impacting Company financials and mostly intended to increase productivity in its operation, not to further mention that this gap between inflation and the tariff adjustment with full, immediate pass-through of productivity gains adversely affects the Company's investment capabilities.

That concludes our initial remarks, and we would like to open for questions and answers. Thank you.

## Questions And Answers

### Operator

(Operator Instructions) (Chris Newman), Brean Murray, Carret.

#### Q - Chris Newman {BIO 18699239 <GO>}

I just have one quick question, and it has to do with interest expense. I noticed it was very low in the Second Quarter. It would just be helpful from a modeling perspective if you could maybe give us some guidance or maybe refer us to a previous quarter amount as something we should be forecasting going forward.

#### A - Mario Arruda Sampaio

Chris, as you know, we won't give you any guidance. But we can comment quickly on the reasons it came low. Remember, it's quarter over quarter. We did have this major amortization of the eighth debenture. We did have in this quarter, by the way -- we amortized more than we have brought in new money, so we actually reduced our net debt overall and, mostly, net debt to EBITDA.

What we can say is, obviously, to some extent, we also have acquired lower interest debt last year, mostly Eurobonds. If you consider also that there was no exchange variation negatively affecting, that certainly helped the overall interest to go down.

Let me see if I can get something extra with my group here to complement that. Just a sec. We're trying to see how we can convey to some extent the part of how do we see this now.

The level of interest expenses -- I think they're fairly stable. We obviously have been benefited by the exchange favorable to the real. It's hard to say in the future not only the

exchange rate but, given market conditions, where the interest rates will go.

What we know is that we have an investment plan that is ongoing. We have hired -- signed significant amounts of very low-cost, long-term financing for the investments, which we'll be incorporating as we move forward. We will be, as we have done in the recent years, refinance a substantial part of maturing debt. And I think we have been able to do it on a better term than we had.

So I think we cannot guarantee that we will continue to do as good, given all the volatility we see in front of us. But bottom line, interest expense, yes, came in very low compared to other quarters. I think, potentially, it's a very specific quarter-against-quarter comparison. As we move forward, you would see fairly stable but depending, obviously, on the exchange rate and on the interest rates, mostly local interest rate, as we have a significant portion of debt in local debt.

**Q - Chris Newman** {BIO 18699239 <GO>}

Okay. Thanks so much. That's very helpful.

## Operator

(Operator Instructions) It appears that there's no further question. I would like to turn the conference back over the SABESP for their final remarks.

**A - Mario Arruda Sampaio**

Thank you, everybody that attended the call. I'm sure that, if you still remain with any questions, that you might want to directly send it to SABESP. We are totally available in the IR group. Thank you very much, once more, for your time. See you soon, next quarter release. Bye-bye.

## Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines.

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