

Q2 2017 Earnings Call

Company Participants

- Jerson Kelman, SABESP
- Marcelo Miyagui, Unknown
- Mario Arruda Sampaio, Unknown
- Rui de Britto Ãlvares Affonso, SABESP

Other Participants

- Humberto Medina, Research Analyst and Senior Investment Analyst
- Lilyanna Yang, Analyst, LatAm Utilities, Oil and Gas
- Marcelo SÃi, Associate Director and Analyst
- Snehal Rajnikant Amin, CEO and Portfolio Manager
- Vinicius Canheu, Director of Latin America Equity Research
- Vinicius Tsubone, Analyst of Latam Utilities, Oil & Gas

Presentation

Operator

Good day. 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 2017.

The audio for this conference is being broadcast simultaneously through the Internet on the website, www.sabesp.com.br. And on the MZiQ platform, where you can also find a slide show 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 Jerson Kelman, CEO; Rui Affonso, Chief Financial Officer and Investor Relations Officer; Mario Arruda Sampaio, Head of Capital Market and Investor

Relations; Silvio Xavier, Head of Costs and Tariffs; and Marcelo Miyagui, Head of Accounting.

Please note, this event is being recorded. Now, I turn the conference over to Mr. Arruda Sampaio. Sir, you may begin your conference.

Mario Arruda Sampaio

Okay. Thank you. Good day, everybody. Let's start our conference call. We have some new slides in our presentation. And as usual, at the end, we -- let's open for question and answers.

Let's start on Slide 3. Here, we show the company's billed water and sewage volume. It was up 2.7% in the Second Quarter of '15, with an increase of 2.9% in water and 2.4% in sewage compared with the same period of '16.

On this slide, you can also see billed water volume, which has been increasing since the Third Quarter of 2015 when the water situation began to improve.

Quickly now to Slide 4. Let's go through very briefly through our financial results. Gross operating revenue increased 6.5% over the Second Quarter of '16 due to: First, the 8.4% tariff increase in May '16; second, a 2.7% upturn in total billed volume. As mentioned, 2.9% of which is water and 2.4% is sewage; third, the granting of bonuses totaling BRL 33.6 billion in the Second Quarter of 2016 as part of the Water Consumption Reduction Incentive Program, which ended in April 2016; and finally, the lower provision for loss of wholesale revenue in Second Quarter '17 in the amount of BRL 21 million due to payments received in the period.

It's worth also noting that the increased costs by these factors were, we have just mentioned, was partly offset by the end of the contingency tariff at the same time as we ended the incentive program that is in April '16. And in this case, totaled BRL 64 million in the Second Quarter.

Costs in selling and administrative and construction expenses increased 5.1% or BRL 133.4 million in the period. Adjusted EBITDA totaled BRL 1.065 billion in Second Quarter '17, 4.6% lower than the BRL 1.1 billion recorded in the same period of the previous year.

The adjusted EBITDA margin came to 30.5% in the Second Quarter of '17 against 32.5% in the Second Quarter of '16. If we exclude the construction revenue and construction costs, the adjusted EBITDA margin goes -- increases to 38.7% in the Second Quarter of this year against 43.1% in the Second Quarter of '16.

Last, the net income was BRL 331 million compared to BRL 797 million in the Second Quarter of last year. You should note that if we just consider the exchange variation effects and the facts of the impact on income tax, the profit for this quarter would have reached BRL 471 million.

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Let's move to Slide 5. We here, again, very briefly, we will present the main variations in costs for the Second Quarter of '17. If we compare all the costs and selling and administrative and construction expenses, there was an increase of 5.1%. If we exclude construction costs, the cost and expenses edged in other words, increased by 14.2%.

Costs and expenses represented 78.7% of net revenues this quarter compared to 76.1% the same period last year. The items that grew the most in percentage terms were general expenses, up 43.7%; salaries, payroll charges and pension plan of deviations, up 15.2%; and services, up 10.6%. Worth noting the substantial decline of 22.6% in electricity costs.

Again, for a more detailed explanation of our costs, please refer to the earnings release.

On Slide 6, let's quickly also go through the main variations that affected net income. We here then present the main year-on-year variations, which totaled, at the end, a net income of BRL 331.8 million.

Net operating revenues increased 1.6%. That is BRL 56 million, while costs and expenses, plus construction costs moved up BRL 133.4 million, or 5.1%.

Other operating revenues and expenses added -- were, sorry, BRL 1.8 million lower.

Net monetary and exchange rate variations and financial expenses had a negative variation of BRL 653 million. This is mainly and almost fully due to the appreciation of the dollar and the yen against the real in the Second Quarter of this year. That is 4.4% and 3.5%, respectively, when compared with the devaluation of these 2 currencies in the Second Quarter of '16, which was 9.8% for dollar and 1.4% for yen.

Finally, income tax and social contribution fell BRL 267 million, mostly due and as a result of lower taxable income and again, mostly driven by the appreciation of the dollar and the yen against the real.

Let's now move to Slide 7. This is where we're going to review the reservoir supply situation in the Metro region of São Paulo. Please, very important to bear in mind, as we start, that it is normal for the reservoir levels to fall this time of the year in the region we operate, the Metro region of São Paulo, the rainy season is concentrated between October and March, becoming scarce between April and September. In fact, the reservoirs exist exactly to guarantee water supply during this period.

Although July was the driest month in the last nine years, the Cantareira closed the month of -- at 62.8% of its operational volume.

On June 30, just a comparison, 2013, that is the year before the water crisis, this level was 53.4%.

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It's also, like to mention, very important that the consumption patterns of the population of the São Paulo Metro region has changed after the '14, '15 water crisis. And that water production volume currently required to serve this population is 15% lower than four years ago, which puts less pressure on water availability.

We also like to highlight the constructions work progress of the 2 major projects that will substantially increase water availability in the Metro region of São Paulo. The first, the Jaguari-Atibainha interconnection that, when concluded, will be able to pump an average of 5 cubic meters of water from the Jaguari reservoir situated in the Vale do Paraíba region and water basin to the Atibainha reservoir that belongs to the Cantareira system. This project is already 76% complete as of -- up to June. And we all expected to be concluded on time by year-end.

The second, the new San Lorenzo water production system. This will increase water availability and up to 6.4 cubic meters per second. The works are 75% completed by June. In this case, the expectation. And we all understand it will happen, is that the works will be concluded by the end of the First Quarter '18.

Let's now go to 2 subjects, which are very important for all. First, let's go through the Tariff Revision Process.

As you all know, we are in the second tariff review. And in this sense, on August 7, our ARSESP announced the new schedule for the initial stage of the preliminary tariff revision where at this stage, it was established that the public consultation will begin on August 14, that is today. And will end on September 4.

As for the disclosure date of this preliminary tariff, it was set for October 3. At the same time, the date before the disclosure of the final tariff remain on April 10, 2018.

So in this context and for the purpose of the public consultation, on the 11th, that is last Friday, the agency issued the initial technical note with its proposal for the preliminary tariff and regulatory walk. Among the information disclosed, we would like to highlight the following, initial regulatory remuneration at base of BRL 40.3 million, regulatory walk of 8.01%, preliminary average tariff of 3.6265 cubic meters -- per cubic meters and tariff repositioning rate of 4.365%.

Regarding the technical note, we'd like to first highlight its quality and transparency. We know of the efforts and work of the agency to get where we are today and the barriers and obstacle it faces throughout this process. But certainly, that did not stop them from carrying out the work they now present.

Note that as important as the result achieved in the process, it's how you got there or how you get there. In this sense, there's a clear evolution from the first tariff cycle, which provides more security in managing the company and the provision of the services to our customers. And for those who lent capital in the form of debt or equity.

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But as we know, this stage is the beginning of a process that will end in April '18. And as the name of this stage itself says, it is a preliminary stage. This means that everyone should be aware that despite differences that would certainly be pointed out by us and other participants, in the process, there are still more steps and time for clarifications and convergence of technical understanding in the sense that, that has been focused on reviewing the technical notes since last Friday and so we'll continue obsessively throughout the entire process and public consultation period.

So that we are available to clarify any doubts that you may have on the technical note. But we will refrain and avoid issuing any opinions, judgments and position in anticipation of the disclosure of our contributions to the regulator, which should happen by the end of the consultation period -- public consultation period.

Move now to Slide 9. As you must know, the following -- I'm sorry, as you must be following, on May 15, during our teleconferences results for the First Quarter of this year, we commented on the privatization program of the government of São Paulo, which authorized the hiring of professional services to begin studies that would allow the capitalization of SABESP. Since then, IFC, International Financial Corporation, that belongs to the World Bank Group has been hired and will carry out all the study on debt capitalization and also provide financial advice.

More recently, on August 2, the Government of the State of São Paulo sent to the State Legislative Assembly a bill on SABESP corporate reorganization. Remember that there has to be a legislation approval for this process. This bill will be processed on an emergency basis and was passed through 4 commissions before approval, which are, the constitutional and justice commission, infrastructure commission, finance commission and planning commission. Our expectation is that the bill will go to vote in approximately 45 days.

Below, we will highlight the bill's main authorizations that will be given to the state government, which are: To set up a controlling company and capitalize it with its shares; to sell its shares in the holding company to private investors, provided that it maintains direct and indirect control over SABESP; find a management agreement with a holding company of SABESP. And this is in order to provide more transparency in the relationship between all parties and provide room and flexibility to managers in managing the business and (inaudible). It also provides the government more powers -- the government will be able to also provide more powers to the minority shareholders as long as this does not impede the state government from exercising control over the company and implementing key public policies.

Note that we are all -- now that we are all updated on the steps so far taken in this process, we'd like to align the understanding on the objectives of the capitalization process and expected impacts for the minority shareholders of SABESP.

First of all, giving SABESP listing in the dollar mercado, any capitalization process will require the state government to follow on in the same proportion of its current holding, without which it will lose control of the company, whether it's neither permitted nor

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desired. Given this, what is proposed with this initiative is to create a mechanism to enable and circumvent this situation without harming or reducing the fundamentals and transparency that SABESP has always practiced along with all its shareholders and the market.

More specifically, although the model on the study, mainly to the government -- the state government to exercise control directly of the controlling company or holding. And indirectly over SABESP. At the same time, all this with a lower economic stake than the minority shareholders, the main and central objective of this initiative is to enable SABESP to do more, that is grow its businesses and expand its performance and coverage. And at the same time, do better, which means unlocking the many ties that today are applied to SABESP and that it means that more value is extracted from its activities.

In this process, a very special care and attention will be given by the state of São Paulo government and by SABESP in the search for a potential investor with a maximum alignment of interests with those of the current minority shareholders in SABESP. In fact, this is fundamental in our understanding for the success of the process and needed to create the maximum value that should benefit equally the minority shareholders of the controlling company. But also of those of SABESP.

In summary, one of the central points of the process is to identify and bring to the controlling company, or holding, one or more investor whose objectives converge clearly with those of the minority shareholders of SABESP and its executives in the search for more efficiency, growth and return.

Let me take advantage and quickly comment on SABESP 21st debenture issue that was settled on July 13. This is part of the effort of the debt refinancing process that we engage on an ongoing basis. This is the 21st debenture -- the first operation priced to the market since 2013 when we issued our 17th debenture. Since then, as you all know, Brazil has entered into a political economic crisis. The market has closed completely and treasury and credit operations prevailed until the end of 2016 when after which when confidence improved and the investor left in search of good names.

During this time and same period, SABESP faced its worst water crisis and surpassed it without any financial imbalance and risk of shortages, as you all followed. And in spite of the recent turmoil generated by accusations against our President, what led to a momentary uncertainty and volatility to the market, there was a high demand at the day of the book building, that is 2.6x the value of the offering, which was BRL 500 million. This allowed the company to settle the deal at the best possible combination between price and terms. In fact, the debenture was issued with 2 series. The first with BRL 150 million and three years maturity. And the second with BRL 350 million maturing in the fourth and fifth years. As for the cost, they were also very attractive, with the first series coming out at the cost of CDI plus 0.6% per year, while the second series was at CDI plus 0.9% per year.

Very important, these prices represented a relevant discount to the reference price, which demonstrates the success of the operation and the positive market feel on SABESP,

especially after overcoming the water crisis and facing such adverse economic and political environment.

So that concludes our initial comments. And now, let's open for questions and answers. Thank you.

Questions And Answers

Operator

(Operator Instructions) The first question comes from Marcelo Sa with UBS.

Q - Marcelo SÃ;

So I have one question following up the past conference call that you guys did. It's regarding the average tariff, on the current average tariff of the company. So one of the questions was that regarding the tariffs that the company charges for the wholesale. And the company charges a tariff that is slightly -- actually, not slightly but below the maximum tariffs approved by the regulator. So what we tried to do here is that we did an exercise in order to assume that what would be the effective current tariffs if the company charged the maximum tariff for the wholesale? If that's the case, we get to an average tariff of BRL 3.3 instead of BRL 3.23. So there will still be a huge gap to the BRL 3.47 per cubic meter calculated by the regulator. So I think, the problem with the most of the difference could come from the tariff structure. Then, I would like to see if you guys have done any analogies where they said if this is -- the main difference comes from that structure and not from the discount in the wholesale?

A - Mario Arruda Sampaio

Just a second, we are just working our way to answer the question. Just one more second.

A - Jerson Kelman {BIO 7373310 <GO>}

Marcelo, this is Kelman. Look, we are also puzzled by how the ARSESP has done the calculation. We don't know. So to begin the answer is, we don't know. But we don't think that, say, the tariff structure would answer the question. We are thinking. But we have no confirmation from the technical notes issued by ARSESP. We're not sure. But we are just wondering that maybe they are considering different volumes and different consumptions according with the consumption classes. So it seems to us that possible explanation for this mystery is that they are not considering the same consumption volume for 2017, the year of reference in the numerator and denominator. I don't know if you follow, my English is so bad. Did you understand what I'm trying to explain?

Q - Marcelo SÃ;

Yes, sure. But I did another exercise that maybe it would help, is that instead of, for example, dividing the revenues by the billed volumes, if you divide the revenues by the produced volumes minus water losses. And then you're going to get the effective volume that was delivered, I get to exactly the 3.47. So my question here is probably is that, I think

that the company, because of tariff structure, if you consume less than 10 cubic meters per month, the billed volume is 10. I think that the regulator, instead of considering the 10, they're considering the effective volume that was delivered, maybe 7, 6. And therefore, they get to a higher average tariffs maybe. That could be one of the reasons. So the volume is actually different than what the regulator is considering in what is actually the volume that SABESP is billing the consumers.

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A - Jerson Kelman {BIO 7373310 <GO>}

Well yes, these are several hypotheses what the regulator is doing. This, perhaps, is one of them. And of course, in our overall cost, we have to consider also the production of water for wholesale. And of course, the regulator is already considering that the corresponding revenues will get there. So if he's considering that the default by the cities that are not being asked should not be paid by the other consumers of our cities, then the corresponding course of not producing this water should also be considered. But okay, it just are -- we see, it's very difficult to, at this stage -- you are doing some exercise trying to explain. We are doing the same. And I don't think that during this kind of call, we are going to reach a conclusion. And as Mario said in the beginning, we are going to study the issue and say, we are -- since we understand what the regulator has done. And probably, we will agree with. At this stage, we think that we disagree. Then, of course, we are going to make our point very clearly to the regulator. Okay?

Operator

The next question comes from Humberto Medina with C&S.

Q - Humberto Medina {BIO 16770607 <GO>}

I realize that at this point, you guys don't want to comment ahead of your formal filing on the preliminary tariff that is obvious to anybody that has been looking at the process that this is grossly insufficient. And we hope, as investors, that you guys will try to forcefully make that clear. Ultimately, what would make the expected offering to a private investor or through existing shareholders of a minority stake would be the same regulatory process. If this regulatory process does not fully, or at least close some of that regulatory gap that you have, then there would be a lot of credibility issues going forward. This is the time to do it. I think, you guys understand then. And I hope that the process reflect some of these issues. More specifically, I wanted to ask you on the cost side. Obviously, the regulatory EBITDA seems to be, not the first, still below what you guys should be getting given your actual investment. But even if we use the regulatory EBITDA with the preliminary rate adjustments, you would not be earning that allowed EBITDA because of your disallowed cost. Can you talk about the costs that are being disallowed by this preliminary tariff methodology? And what can you do so the regulator understands that those costs should be included in your tariff?

A - Mario Arruda Sampaio

Humberto, just a second, please. Thank you.

A - Jerson Kelman {BIO 7373310 <GO>}

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Humberto, this is Kelman. First, let me tell you that we are fully aware of our responsibilities in terms of defending the interest of the company towards what the regulator is doing. So we are -- this is why we are cautious at this stage. We don't want to issue anything that we are not completely sure. So we are going to defend the interest of the company before clarity of the -- ask more clarity and transparency from the regulator when we know exactly what we are claiming. At the moment, the technical note issued by the regulator is as what it was said in the beginning. Much, much better than in the first cycle. But still has too many dark, dark or no transparency parts. So one of the parts that is particularly obscure is what the regulator has done with our detailed plan of OpEx. There is a very large discrepancy between what we had asked for OpEx, which detailed information year by year. And what the regulator has accepted in the technical note. And the technical note, as I mentioned, does not bring what was the methodology that the regulator has used to disagree with us. So we are going to ask more transparency from the regulator on this particular issue, which is OpEx. Several others. But in this in particular, we are also concerned. I don't think our, say -- we are restraining at this stage. Don't think this is something that we are afraid of asking the regulator to be more clear and confronting the regulator when we think that they are not right. But as we said in the beginning, what the regulator has done in this particular -- the technical note this time is much better than in the first revision.

Q - Humberto Medina {BIO 16770607 <GO>}

Okay. Thank you for that clarification or comments. My second question is regarding the RAB. And this goes to the discussion during the Portuguese call. And personally, my Portuguese is not great. Can you clarify what was said in terms of potentially arguing for the incorporation of the disallowed investments? I think, it was mentioned, the BRL 6 billion for example, that you and others have pointed to, investments that you should be given credit for and you're currently not being given credit. Just talk about why do you think it was not included? Are you going to try to push for that to be included? Why not, if that's not the case?

A - Jerson Kelman {BIO 7373310 <GO>}

Okay. This is Kelman again. There is important move forward that was not noticed so far. In the first revision, as you said, the regulator did not accept something like BRL 6 billion. And there was no clear explanation for that. What the regulator has promised us is now to give before April '18, which is the closing of this revision process, they will provide us with a clear report of what -- why they have, how to say, excluded some of the items. This is the first piece of information. The second piece of information is that those -- all those assets that were excluded in the first revision, summing up some BRL 6 billion currency at the time, BRL 1 billion, they have now changed their minds. This is related to iron pipes that, in the first revision, they excluded the cost of these iron pipes from the base -- the revenue base because they thought that iron pipes would not be used currently. This will be something from the 19th century. But we could prove to them that in some circumstances, iron pipes are actually needed and cannot be replaced by other material. So they changed their minds and they accepted from something that are nowadays, the current prices would be some -- of the order of BRL 1 billion.

Q - Humberto Medina {BIO 16770607 <GO>}

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Okay. And my last comment, I guess, is -- and I think you guys fully understand this. But perhaps, it might be worth just emphasizing that with the regulator. I think, here, the perfect maybe enemy of the good, meaning that I understand that there might be willingness that over time, that regulator would address all the claims that you have. But I think, it's very important for the market to gain confidence in what you guys are doing and, ultimately, confidence that might enable for you guys to finance this large investment plan that is going to be ultimately beneficial for consumers is for a good outcome hearing in terms of a clear demonstration that the regulator is addressing the issues and the regulatory lag and we're moving in the right direction. If we continue to see major postponements in some of these issues and there's not a substantial rate increase that allows you to earn closer to your allowed returns or you're not even close, that might be very, very detrimental long-term. And I know you guys understand that. But I just wanted to emphasize that. As an investor, I'm happy to share that if you think it has any value even in the hearing process.

Operator

The next question comes from Vinicius Tsubone with HSBC.

Q - Vinicius Tsubone {BIO 20139966 <GO>}

My question is regarding the pass-through, the tariffs of the contributions to the environmental and infrastructure fund of the São Paulo City. When does the company plan to start this discussion again? And could we expect that the (inaudible) to be published in April next year will include this pass-through?

A - Rui de Britto Álvares Affonso {BIO 5808118 <GO>}

It's Rui speaking. This issue has been under discussion for many years, not only -- (inaudible) continually SABESP and the regulator. But also, it's related to our consensual powers in the case of São Paulo City as it resides in the Metropolitan region, concerning to the municipality of São Paulo and also to the State of São Paulo. Remember, for several times, there have been this clarification of this issue and implementation of this pass-through cost from our opinion. And also from ARSESP has been suspended by the intervenience, the request of the both sides of the consensual power. I mean, the municipality and state level. The last decision that ARSESP provide to the public was that the 7.5% was to be addressed at the end of the revision process. What happened is that in the middle of the road, we have a preliminary revision process. At that time, it doesn't exist at the time. So we -- the time frame for the decision of the 7.5% is to be concluded at the end of the tariff revision process that ended, finally, at April 2018. That's the point. And that's we are.

Q - Vinicius Tsubone {BIO 20139966 <GO>}

Okay. So just to clarify, only after April, right?

A - Rui de Britto Álvares Affonso {BIO 5808118 <GO>}

The last decision of ARSESP insist -- motivated by the request of both municipal level and state-level governments was that, that should be decided, finally, at the end of the tariff

revision process that ended in April 2018.

Operator

The next question comes from Snehal Amin with WindAcre.

Q - Snehal Rajnikant Amin {BIO 6232026 <GO>}

I have 2 questions and a comment. One, given there's a bunch of discrepancies in this ARSESP note between the 4.3% tariff increase, the PO number of BRL 3.63 in the required revenue, which number should we focus on as being the most significant and the one that SABESP will eventually actually achieve? I mean, will you only put through the percentage increase? Or will you achieve the required revenue, irrespective of what percentage increase or what PO comes out of that because that's the required revenue is what you actually need to generate a return. But can confront to us which number really matters?

A - Jerson Kelman {BIO 7373310 <GO>}

The required revenue is the relevant number. All the calculations done to find what is required revenue. And then the PO is just the division of required revenue by the volume. So the required revenue is what really matters. The percentage of increase is exactly what we are not understanding and this will be a matter we are going to ask the regulatory agency to clarify this because we are also not understanding what they have done essentially. We don't understand what was the previous tariff that they are using. So long answer to -- very simple, the required revenue which is really matters. Okay?

Q - Snehal Rajnikant Amin {BIO 6232026 <GO>}

Okay. Then -- so if that's the case, then does it matter in the end -- if ARSESP uses a volume number that SABESP does not agree with, because ARSESP wants to just use something, its own calculation. But it's not the real billed volume that you sell, right, the actual build volume. If there's a discrepancy there, does it matter or not? Because you say, fine, ARSESP, you can use that volume, I'm going to use a different volume number, which is the actual billed volume. And I'm going to charge the tariff I need to charge on the billed -- on my actual billed volume so I can get to the regulatory revenue that we both agree, right? So is that the way it works?

A - Jerson Kelman {BIO 7373310 <GO>}

Look, there is no discrepancy between us and the regulator in terms of what is the volume target for 2017, '18, '19, '20. So we agree with the regulator on the volumes that we sell. And we also -- don't agree. But the regulator has said what is the required revenues. So this doesn't -- this means that we have to discuss with regulator what is the adjustment in tariff. We cannot just apply the percentage that you think is correct. We have to clarify to regulator. And what you're saying is probably right. This one hypothesis, maybe the regulator is not considering our actual sales of water. If this is the case, he has to adjust to what really is happening. But we have to discuss with regulator.

Q - Snehal Rajnikant Amin {BIO 6232026 <GO>}

Okay. Okay. I think I understand. Then, the second question, there's been a lot of delays in this process, right? I think, my understanding was the original rate review should have been effective, I think, April 17, if I'm not mistaken. So if the final one is only going to happen in April '18, there's a lot of lost value and lost revenue. Is there a regulatory asset that's going to build up? Or something that will compensate the shareholders for this delay?

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A - Jerson Kelman {BIO 7373310 <GO>}

Yes. The regulator, in April '18, when it finishes the whole process, it will calculate all the rights you have, given the fact that there was a postponement of the revision. So in his technical note, it has made it clear that in April '18, he will do all the calculations back to adjust the whole thing as if -- in terms of economic terms of course, to make it even with the fact that the revisions should be done on April '17 and not April '18. Okay?

Q - Snehal Rajnikant Amin {BIO 6232026 <GO>}

Okay. So there will be compensation. Okay.

A - Jerson Kelman {BIO 7373310 <GO>}

Yes, yes, yes.

Q - Snehal Rajnikant Amin {BIO 6232026 <GO>}

Okay. Great. Then, just one comment, as I was thinking about the previous question, the 7.5% São Paulo fee, I mean, it seems very clear, right, that this fee needs to be passed through and there's really no economic argument, I think, that anyone can make that says the shareholders should suffer the cost of this and as a result, the business shouldn't earn its required cost of capital. So I know you agree with that. But if the regulator, for some reason, doesn't pass this through, I think, they should understand, it's an extremely damning situation because it smells of politics, right, which is exactly what the company is trying to free itself from. So -- I mean, you can always debate to some extent what the right RAB is and get very technical. But there really is no debate that this fee is not a fee that the shareholders should pay, right? It's a fee that the -- the shareholders are entitled to get the required return. And this fee needs to be put through in the tariff. So hopefully, the regulator understands. And the other various -- I realize the city and the state and the municipality. But they're all going to suffer if this decision ends up being a political decision. And they'll end up suffering in amounts that are much larger than the 7.5% fee if people can't trust that something that's state-owned is going to get treated fairly. So I just wanted to reiterate that, not so much to you. But hopefully, to the government and the regulators, that they understand the significance of this.

A - Jerson Kelman {BIO 7373310 <GO>}

Well look, this is not a regulatory issue. There is a conflict of understanding between the 2 concession entities here. As you know, in the metropolitan areas, there are 2 entities that - the concession São Paulo, the state and the municipality. And in this case, there is a conflict between the attorneys of the state and attorneys of the municipality. The attorneys of the municipality think and have put this on written that this payment is not passed through to the consumers, it's something that the company is paying to the -- to have the

right to serve the city for which we take more than 50% of our revenues. The state attorneys think just the opposite. And what we are trying to do is to make the 2 political entities, the 2 governmental entities to reach an agreement. It's not an issue that the regulator can solve by himself.

Q - Snehal Rajnikant Amin {BIO 6232026 <GO>}

Yes. Yes, I understand that. I guess, my concern is this issue has been going on for years now, right? And in some ways, there's really not much of an incentive for them to resolve it, right, because politically, they may not -- no one wants to see the tariff go up, politically, right? The people that really care are the shareholders of SABESP who are paying this fee every year and as a result, not earning the fair return on the RAB, right? So that's my concern. And the longer it goes on, I think, the more damning it is that the company isn't getting treated as it should get treated, right, as a regulated business that's entitled to earn its rate of return. It can never earn it so long as this fee exists, right? It's never going to get close to earning it.

A - Jerson Kelman {BIO 7373310 <GO>}

You see, this payment is OpEx. And we are not getting back this OpEx. Our thinking is that we should get this and we are working hard on this and the issue is very delicate. The scenarios that we have is not all, well, either we go, for example, go to court and fight municipality. If you do that, we'll have the risk of losing the concession that is more than half % -- half of our revenues. So it's not a simple issue. It's not a simple issue. And what I can say is that the administration is doing the most we can to put the 2 concession entities together and come to our -- attorneys on one side and attorneys on the other side, they should come to some kind of agreement. And this what we are working hard to do. What I want to stress is that in the interest of the shareholders, we cannot be adventurous in the interest of the shareholders because we cannot enter in a dispute with the municipality that we don't know exactly what would be the exit points. So we are being cautious and trying to get the 7.5% as OpEx, convincing the attorneys of the municipality that is the right thing that is written in the conference, this is what we believe and this is exactly what we are -- the point of view that we are defending.

Operator

The next question comes from Lilyanna Yang with HSBC.

Q - Lilyanna Yang {BIO 14003234 <GO>}

One thing, right, on the tariff and equity issuance plan. You know that the tariff is going to be given to you in October. And it's preliminary. And the final one is only in April. And if we check the past history of all the rate reviews and the dialogue with the regulator, the reality has actually disappointed expectations. So I wonder, what are the chances that SABESP and the São Paulo state postpones the equity issuance plans to until after the April 2018 rate review process? And my second question related to this is, what is the ideal level of investments that you believe you can execute going forward? Or how much more CapEx you ideally will like to have SABESP carry on? Would it be a 40%, 50%, 60% increase over the current levels? And I have actually a third question that goes back to this discussion about the São Paulo city fee. I understand that despite the six years of having

this payment not pass through SABESP whilst you cautiously continue to make this payment, right? So at least I would like to know what are the checking points to see if the São Paulo City is spending the money well that is actually going to (qualities) related to water and sewage, environmental issues so that it can have an indirect benefit for SABESP in terms of even avoiding other CapEx, for instance?

A - Mario Arruda Sampaio

Just a second, Lily.

A - Rui de Britto Álvares Affonso {BIO 5808118 <GO>}

Lilyanna, it's Rui. Concerning your first question, we -- our strategy regarding the tariff revision process, including the preliminary and the final one. And the proposal, the deal sent to the state assembly to allow us -- to allow the state to create a holding and capitalize, after that, SABESP, our strategy is to improve and to put pressure on the results of the tariff revision. I mean, what has been done and we wanted to speed up is to have a better tariff revision process, both, of course, on the final result. But also related, as Kelman has said before, to the process of this. So we don't think, nor us, neither the state. And we don't count is the possibility is not in our (inaudible), it's not in our plans to postpone by any chance, the plans for the capitalization of SABESP. So it's the other side to improve the tariff revision process, we believe that this is the way to deal with those 2 process. We know that it generates several uncertainty. But at the beginning of the process, we're starting this process knowing very well that we have to deal with uncertainty. So this is the first point. Second one, we have no precise number. But we have working hard in order to define it, which -- not just the amount. But which projects we can add to our CapEx immediately if you have, again, the opportunity to count with more entity, resources on equity to spend our CapEx. And what we have said is that we have several projects ready to grow with very good returns and capable to increase our CapEx in a short term. That's the issue. The important thing is if you can get this project ready then at the beginning of 2018, we'll be able to speed up our CapEx in a very short time way. That's the second point. The third point, I'll send it to my colleague, that's the Head of Regulation here in SABESP, Mr. Marcelo. Okay?

A - Marcelo Miyagui

Well about the 2 answers that he said that SABESP makes every three months to the municipality of São Paulo, they have transparency rule to follow, okay? So they cannot use the money to do anything they want. There is a municipal law regarding this. And there are strictly permitted objects and they have to publish it all over the Internet. So if you go to the housing department in the website of São Paulo's municipality, we will find all these things we're talking about, okay?

A - Jerson Kelman {BIO 7373310 <GO>}

But let me complete this. They have to apply this money in things related -- in investments related to sanitation. In other words, it's something that we could not provide a service unless they do their part. Typically, if you have to install a pipe where there is a slum, you are not allowed to this. Then, the municipality, with the money that we pay, they go there

and take this part of slum out in order that they can pay us with the part as an example. Okay?

Q - Lilyanna Yang {BIO 14003234 <GO>}

Okay. Perfect. And if I can follow up on this São Paulo City fee controversy, I'm puzzled because São Paulo City, in my view, doesn't seem to have any other service provider other than SABESP, right? At the same time that SABESP, of course, needs São Paulo City as half of the revenue contributor. I would say that. And argue, that the São Paulo City also have no other choice. And if not mistaken, SABESP do owns the assets used to provide service to the city, is that correct? Or am I missing something? Could there be any potential competitor or another service provider for the city instead of SABESP?

A - Jerson Kelman {BIO 7373310 <GO>}

Lilyanna, from the legal point of view, the service provider to the municipality of São Paulo should be some entity which is agreed by the state government and municipal government. And there is no (inaudible) that SABESP would lose these contracts, not at all. What I said before is that we don't want to disturb a (inaudible) very well with something that is not agreed by the attorneys. And they need some work on convincing the attorneys of municipality that what we think is the right thing to do. Okay?

Operator

The next question comes from Vinicius Canheu with Crédit Suisse.

Q - Vinicius Canheu {BIO 6300903 <GO>}

I would like to come back to the issue of the tariff regulatory proposal. When we read the regulator's note, specifically on Page 8, it says that at the end of the process in April, it will be set the compensation adjustment relative to the fact that it's ending right now including those related to the extraordinary tariff review of 2016. I'd like to know if you could share with us what kind of expectations you have related to this item because beginning in 2015, the extraordinary review that was granted to the company was not a fully (inaudible) at that time and then there was this issue about our future compensation and apparently, here, the regulator is reaffirming the fact that it's things about the compensation. I'd like to know what kind of expectation you have and if you could share with us that?

A - Rui de Britto Álvares Affonso {BIO 5808118 <GO>}

Well Vinicius, if we understood the question, what he's saying that in April, he would do compensation adjustment of extraordinary tariff review we asked in '15. So what he's saying is that at the time, the required increase to compensate for volume was not fully given to us. So what he's going to do is he's going to rebalance that cycle based on the actual volume that happened and compensate us for any differences between the business plan original and the difference we obtained in the extraordinary tariff. That's what he's saying. He's going to rebalance not only the first cycle, he's going to rebalance, I'm sorry, the volume on the first cycle. That's the way we understood it.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Okay. So we can have an expectation that it's very likely that like this further compensation will be part of your tariff at the end of this process?

A - Rui de Britto Álvares Affonso {BIO 5808118 <GO>}

Yes.

Operator

(Operator Instructions) It appears to be no further questions. Now, I'll turn the conference back over to SABESP for their final remarks.

A - Mario Arruda Sampaio

Okay. Everybody, thank you very much. And as we mentioned in the first Portuguese call, we are available for what we -- you need in terms of our contributions and answers. And see you soon in the next quarter. Bye-bye.

Operator

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

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