

## Q1 2016 Earnings Call

### Company Participants

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

### Other Participants

- Henrique Peretti, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to SABESP Conference Call to discuss its results for the first quarter of 2016. The audio for this conference is being broadcast simultaneously through the Internet on 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.

We would like to inform you that all participants will be only 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.

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 Market 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. Thank you, and good morning, everybody. This is one more first quarter here 2016 conference call. We have nine slides in front of us. And as usual, afterwards, we will have a question-and-answer session.

So, let's get started on slide three. Here, we show the company's billed volume and then sewage volume, which was up by 1.9% in the first quarter of 2016, with an increase of 1% in water and 3% in sewage, compared to the first quarter of 2015. Thanks to a greater water availability, which has allowed us to increase the volume distributed to our consumers. This was the first quarter since the beginning of the crisis in early 2014, in which we recorded an increase in billed volume.

It's important to bear in mind that since January 2016, we have not yet - we have not been using water from the technical reserve, and the water pressure reduction in the distribution network has been limited to a nighttime period, as was the case before the crisis. The company is producing more water to be distributed to consumers, and we are authorized now to remove up to 23 cubic meters per second from the Cantareira System since February, as opposed to the 13 cubic meters per second to 15 cubic meters per second we were authorized to withdraw in most period - the greatest period and month of 2015. As a result of the increased water availability, we also increased water production volume by 8.8%.

Now, moving to slide four. Let's go quickly over the financial results. Net operating revenue increased 22.7% over the same period last year, chiefly due to the 15.2% tariff increase since June 2015; the lower granting of bonus with an impact of BRL 153.8 million in the first quarter of 2016 versus BRL 211.2 million in first quarter 2015; the application of contingency tariff in the amount of BRL 160 million in the first quarter this year against BRL 79.3 million in first quarter 2015; and the 1.9% upturn in total billed volume, 1% of which in water and 3% in sewage, as mentioned in the previous slide.

Administrative, commercial and construction costs increased 76.3% in the period. Adjusted EBITDA totaled BRL 907 million against BRL 1.35 billion recorded last quarter, while the adjusted EBITDA margin came to 30% this quarter against 55% last year's 2015 first quarter. If we exclude the factor construction revenue and cost, the adjusted EBITDA margin was 37.2% this quarter against 71.6% in 2015 first quarter. Net income totaled BRL 628.8 million against BRL 318.2 million first quarter 2015.

Let's move on to slide five. Let's go through quickly the main variations in costs in relation to the same period last year. In comparison with the first quarter of 2015, there was a 76.3% increase in construction costs and expenses. If we exclude the construction cost, costs and expenses climb by 127.4%. However, if we exclude the effects of the non-recurring GESP, it's the - our agreement with the State of São Paulo that we made last quarter and the reimbursement of BRL 696 million, costs and expenses increased 16.7%. The main items that influenced this upturn were the increase of 312% in general expenses, 51% in electricity, 18.6% in the allowance for doubtful accounts and 7.4% in payroll, benefit and social security obligations. Again, for more detail in all these cost variations, please refer to our earnings, and any doubt, as usual, call us.

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Let's go to slide six. Here, we present, again, quickly, the main variations year-over-year in the items that affected our net income, which, again, totaled BRL 628 million. Net operating revenue increased BRL 559 million or 22.7%. Costs and expenses, including construction cost increased BRL 1.41 billion or 76.3%. Other operating revenue and expenses had a negative variation of BRL 25.6 million.

Net financial expenses, monetary restatement and foreign exchange variations had a positive variation of BRL 1.3 billion, mostly due in great - almost all due to the depreciation of the dollar and the yen against real in the first quarter. That is the dollar reduced 8.9% and the yen 2.4%. All this compared with an appreciation in the first quarter of 2015 of these currencies of 20.8% for the dollar and 20.3% for the yen.

Finally, income tax and social contribution increased BRL 507.7 million due to the increase in taxable income recorded in the first quarter 2016 when compared with the tax loss reported in first quarter last year.

Now, let's move on to slide seven and slide 8. Here we will go through a brief update on rainfall and water inflow in the Cantareira System. On slide seven, we can observe that after rainfall and water inflow in line with expected average for the rain period in the Cantareira System, which ended in March, April was a very dry with very low rainfall.

Now, let's move to slide eight. And here we can see that in April despite the slower rainfall, the Cantareira System recorded an average water inflow, again, which is a water that flows into the reservoir, really builds reservoir capacity. And this was a 24.1 cubic meters per second volume that is below the historical average for the period but higher than the one observed last year and the year before that during the peak dry (09:22) period.

Now, going overall to the - talking about the reservoir conditions when we compared with 2015 and 2014, as we have already mentioned during the rainy period, which began in October last year and then ended March this year, rainfall and water inflow returns to the expected average for the period, allowing the recovery of the reservoirs.

Remember that we have the collaboration of the population in saving water, and it reacts to that measures we've taken to manage water supply and demand, the emergency works carried out by the company, the water network pressure management to reduce water losses, and again, the return of rainfall expected an average for the period has allowed us to end April with the stored volume of 1.134 billion liters of water compared with 589 billion liters in April 2015. And in these both cases, we include the technical reserve. And 556 billion liters in - compared to April 2014, but in this case, we do not include the technical reserve.

Now, again, due to the investments undertaken to extract water from the technical reserve in 2016, the company has 545 billion liters more than 2015 and 578 billion liters more than 2014. Obviously, this figure less is prior to the technical reserve - or ability to tap technical reserve. Now, again, since the beginning of the bonus program in February 2014 to the

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end of April. There was a savings of 332 billion liters of water. This is the amount of water we saved.

To give you an idea of what this represent, this is the equivalent to almost 2 Guarapiranga reservoirs. And the amount saved is sufficient to supply the entire population of the São Paulo metro region for approximately 30 days - 100 days. Now, from April to September, as you know, we - occurs the dry period and with that the period of expected lower and less (11:44) rainfall. Remember also that along with the dry period, there's a reduction in temperature and hence a reduction in the volume of water used by people. This is very important to set expectations for the upcoming month. Well, then, in sum, the reservoirs received water during the rainy period in excess of demand and the extra amount is then used during the dry season. Remember, it's very important to remember that.

And then considering that the reservoir's levels at the end of March, the beginning of the dry period, even with the very low rainfall in April, as previously commented, it does not alter the decision taken by the company so far, especially concerning the end of the contingency tariff, the bonus program and the increase in production and supply of treated water.

Now, let's move to slide 10. Here, we can see the evolution of water production in the metro region of São Paulo from the beginning of the water crisis in February 2014 all the way to April 2016. The increase in production since October 2015 until now is supported by the recovery of the reservoirs and very much driven by two factors.

The first factor is the authorization to increase water withdrawal from the Cantareira System, again, which went from close to 14 cubic meters to 19 cubic meters in January this year and now 23 cubic meters since February. The second is the completion of the interconnection of the Billings reservoir to the Alto Tietê System, which we have been commenting, which enabled the transfer of 4 cubic meters per second from that to this reservoir.

Note that the greater water availability in the Alto Tietê System increases the water security of this system and consequently of the entire metro region. And so, though the emergency (13:43) works carried out by the company in the years of 2014 and 2015 resulted in 6.5 cubic meters of more water available for treatment. Furthermore, as already mentioned in previous calls, the San Lorenzo water system with 31.9% of the works already carried out is scheduled for completion in late 2017. Remember that this system is totally new and increases the ballpark availability and treatment capacity for the metro region, São Paulo, at 6 cubic meters per second.

Again, also, under construction is Jaguari-Atibainha reservoir interconnection project will add an average of 5.13 cubic meters per second of bulk water availability to the metro region of São Paulo through the Cantareira System. In this case, the construction has begun. It's already on the works since February this year and should be ready by 2017. So, in total, in the period of 2015 to 2017, there will an expansion in water availability and security of close to 21 cubic meters per second and an increase in production of 7.4 cubic meters per second.

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Just to put in perspective prior to the crisis, we had an approximately 75 cubic meters of bulk water availability and close to 70 cubic meters of water production capacity. So, this is a very big leap in a very short-term, increasing substantially our water security for the metro region.

So, in summary, our active management of water supply and demand in the region, the greater availability and increased water security and the average and favorable rainy seasons of 2015, 2016 are all very positive factors that allow us to say that we are today in a better conjuncture and structural situation than last year and with a greater certainty to face the balance of this year and next year.

Let's go to our last slide, we will comment here on the tariff adjustment and the cancellation of the bonus program and the contingency tariff. As you probably know, on March 31st, our staff accepted our request for the cancellation of the bonus program and the contingency tariff for the billed meter as of May 1. This request was made in light of the improved water conditions combined with the conclusion and the advance progress of works to increase water security, which allows us for greater predictability of water source conditions and water security levels in the metro region of São Paulo.

Since its inception in February 2015 until the end of March 2016, this bonus program resulted in a reduction of revenues in the period of BRL 1.456 billion. This reduction was partially offset by an additional revenue of BRL 606 million obtained with the implementation of the contingency tariff. So, in net terms, during the application period, the bonus program and the contingency tariff had a negative effect on revenues of BRL 796 million. As we move forward, we will not see that.

So, considering this, the cancellation of these two measures, especially the bonus program and with its incentive to reduce consumption, the specs of these reduction can build volume and average price given that a lower consumption leads to a lower tariff rate no longer will occur suggesting a recovery of revenue in the coming quarters.

On April 11, in line with our regulatory agenda, so we're exactly on time in moving on the regulatory agenda. ARSESP published Resolution 643, which authorized us to apply a tariff increase of 8.4478% as of May 12. This index comes from the inflation index implementation of 9.3864% estimated based on the EPCA variation from March 2015 to March 2016, and it excludes the productivity factor of 0.9386%.

Considering your consumption of - or consumption reading cycles and the procedures we have to go through, please take note that the full impact of this tariff adjustment and the bonus cancellation will be observed only fully in the second half of 2016, more precisely as of August. The full impact of this adjustment, as you can see, we will see better as we move on.

So, finally, these were our remarks. Now, we are open for questions.

## Q&A

## Operator

It appears that there are no questions. Now, I'll turn the conference back over to SABESP for their final remarks.

Pardon me, sir. We do have one question from Henrique Peretti with JPMorgan. Please go ahead.

### Q - Henrique Peretti {BIO 18446440 <GO>}

Hi. Thanks for the opportunity. I'd like to understand why billed volumes increased only 1.90%, if water produced volumes increased at 8.8% in the quarter? What is the catch here?

### A - Mário Azevedo de Arruda Sampaio

Okay. Henrique, I'm Mário. The reason they don't match is that we have the take-or-pay range of 0 cubic meters to 10 cubic meters. So, if people consume less, we still charge the same thing. So, that is the difference. So, people are probably moving within that range, consuming more within that range but not sufficient to trigger aggressively a change in category. So, to a great extent, the take-or-pay from 0 cubic meters to 10 cubic meter is what causes this effect. Okay?

### Q - Henrique Peretti {BIO 18446440 <GO>}

Okay. Thanks.

## Operator

As there are no further questions, this concludes our question-and-answer session. I'll turn the conference back over to SABESP for their final remarks.

### A - Mário Azevedo de Arruda Sampaio

Okay, guys. First, let me just make a quick correction on my speech here. The bonus cancellation and the continuously tariff cancellations will have immediate effect on revenues as of May 1st. Okay? So, different than I said, it will be deferred. It's not deferred, it's immediate. The only deferred full effect is for the tariff increase.

So, okay, I made that correction. Thank you very much for your participation. So, let's come back next quarter with hopefully good news also. Thank you very much. Bye-bye.

## Operator

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

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