

## Risk Factors

### ***Risks Relating to our Control by the State of São Paulo***

***We are controlled by the State of São Paulo, whose interests may be contrary to the interests of other holders of our common shares and holders of our ADSs.***

The State of São Paulo, through its ownership of our common shares, has the ability to control the election of a majority of the members of our *Conselho de Administração* (Board of Directors), the appointment of our senior management and our operations and strategy. The State of São Paulo owned 71.5% of our common shares at April 30, 2003.

The State of São Paulo has from time to time in the past used its controlling interest in our company to direct, and may in the future use that controlling interest to direct, that we engage in certain business activities and make certain expenditures which are designed primarily to promote the political, economic or social goals of the State of São Paulo and not necessarily to enhance our business and results of operations. As a result, actions taken by the State of São Paulo in relation to Sabesp could be contrary to the interests of the other holders of our common shares and holders of ADSs.

***Most of our Board of Directors and senior management are political appointees of the Governor of the State of São Paulo, who are subject to periodic change unrelated to our business needs.***

Each newly-elected Governor of the State of São Paulo typically makes significant changes in our Board of Directors and senior management and, historically, the Chairman of our Board of Directors has been the Secretary of the Energy, Water Resources and Sanitation Secretariat of the State of São Paulo. During 2002, the current Governor, Mr. Geraldo Alckmin, appointed new senior officials for his administration, including Mr. Mauro Guilherme Jardim Arce as the new Secretary of the Energy, Water Resources and Sanitation Secretariat. Mr. Arce was also elected as Chairman of our Board of Directors. In addition, during the last twelve months our Board of Directors has appointed new executive officers, including our new chief executive officer and our new acting chief financial officer.

A reconstituted Board of Directors and new senior management for our company may pursue a strategy or conduct operations in a manner that diverges significantly from our current strategy and operations. Changes in government or government policy could have a material adverse effect on our business, results of operations, financial condition or prospects.

***We have overdue accounts receivable owed by the State of São Paulo and some State entities, as well as a substantial amount of recently negotiated long-term receivables owed by the State, and we cannot assure you as to when or whether the State will pay amounts owing to us.***

Historically, the State of São Paulo and some State entities have had substantial overdue accounts payable to Sabesp relating to (1) the provision of water and sewage services and (2) State-mandated special retirement and pension payments that we make to some of our former employees for which the State is required to reimburse us.

At December 31, 2002, we had accounts receivable due from the State of São Paulo, including State entities, relating to the provision of water and sewage services totaling approximately R\$65.5 million. In addition, at December 31, 2002, we had R\$83.2 million in accounts receivable due from the State in respect of State-mandated special retirement and pension payments to some of our former employees of Sabesp. Under a federal law enacted in December 1996, we are not permitted to write-off any amounts owing to Sabesp from the State of São Paulo, our controlling shareholder, or entities controlled by the State. We have not established any provisions for any amounts owed to us by the State.

In September 1997 and December 2001 we entered into agreements with the State under which the State agreed to settle amounts the State owes us in respect of water and sewage services provided to the State and State-controlled entities and for State-mandated special retirement and pension payments which we made to some of our former employees for which the State is required to reimburse us. Under the terms of these agreements, the amounts may be settled through the application of dividends payable by us to the State and by the transfer to us of certain reservoirs which we use but which are owned by the State. However, the agreements do not require the State to apply all dividends payable by us to the State to in respect of these amounts. In addition, the agreements provide for an extended period of time before any transfer of the reservoirs to us is effected. Since the State has entered into these agreements, it has applied some, but not all, of the dividends payable by Sabesp to it.

Under the December 2001 agreement, we converted a substantial amount of overdue accounts receivable due from the State of São Paulo and some State entities to long-term accounts receivable.

We cannot assure you as to when or whether the State will pay overdue amounts owing to us, or as to whether the State will continue to apply dividends payable to the State to settle amounts owing to us by the State and some State-

controlled entities. Furthermore, due to the history of the State not making timely payments to us in respect of services provided by us or timely reimbursing us for the State-mandated special retirement and pension payments we make, we cannot assure you that the amount of accounts receivable owed to us by the State and some State entities will not significantly increase in the future. If the State does not pay the amounts it owes us, our cash flows, results of operations and financial condition will be adversely affected.

***A portion of long-term accounts payable by the State to us will be settled by transfer to us of State-owned reservoirs in the Alto Tietê System and we cannot assure you of the value to be given to these reservoirs or the timing of these transfers.***

Under the December 2001 agreement referred to above, the State agreed to transfer the reservoirs in the Alto Tietê System to us in exchange for the cancellation of a portion of accounts receivable due from the State and reimbursement due from the State for State-mandated special pension payments we have made. Under this agreement, the value of these reservoirs would be determined by an appraisal process prior to their transfer and amounts owing to us from the State are subject to an audit by a State-appointed auditor.

Under the December 2001 agreement, in July and August 2002, a State-owned construction company, on behalf of the State, and an independent appraisal firm, on behalf of Sabesp, presented their valuation reports relating to the reservoirs. The appraisals contained in these reports were in the amounts of R\$335.8 million and R\$341.2 million, respectively. Under the December 2001 agreement, the arithmetic average of these appraisals will be deemed to be the fair value of the reservoirs. Since we have made investments in these reservoirs, the arithmetic average of the appraisals submitted to our Board of Directors, R\$300.9 million, was net of a percentage corresponding to these investments. Our Board of Directors approved the valuation reports and they will be submitted for approval to an extraordinary general meeting of shareholders, which is expected to be held during 2003. However, we cannot assure you as to when a final determination as to the fair value of these reservoirs will be made, when the transfer of the reservoirs will occur or when cancellation of accounts receivable will take place.

The December 2001 agreement also provided that the legal advisors of the State would carry out specific analyses, which have commenced, to ensure agreement among the parties as to the methodology employed in determining the amount of reimbursement for pension benefits owed to Sabesp by the State. Sabesp's management does not expect these analyses to differ significantly from the amounts we have recorded in respect of these amounts. The commencement of payments with respect to pension amounts owed to Sabesp by the State has been postponed until these analyses are completed, the appraisal report is approved and the credit assignments relating to the transfer of the reservoirs described above are formalized. Under the December 2001 agreement, the original first payment was to be made in July 2002. We cannot assure you as to when agreement among the parties will be reached or when the State will commence making payments in respect of these pension amounts.

***We may be required to acquire reservoirs that we use that are owned by a State-controlled company, and we may be required to pay substantial fees, rent and additional operational and maintenance expenses with respect to our use of such reservoirs.***

In connection with the provision of water services, we use the Billings and Guarapiranga reservoirs that are owned by a State-controlled company. The State, through its control of our Board of Directors, could require us to acquire the Billings and Guarapiranga reservoirs. As a result of such acquisition, our cash position and overall financial condition may be adversely affected. In addition, since we are not currently charged for the use of these reservoirs, we are uncertain as to whether in the future we will continue to be able to use the reservoirs without paying a fee, or what the likely fee scale would be if so imposed. We may also be required to pay additional maintenance and operational costs for our use of the Billings and Guarapiranga reservoirs. If we were required to pay substantial fees or additional maintenance or operational costs for these properties, our results of operations could be adversely affected.

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

***Proposed regulation for the water and sewage industry may negatively affect our operations in the São Paulo Metropolitan Region as well as other metropolitan areas that we serve.***

The Brazilian Federal Congress has been debating Law Project No. 4,147 of February 21, 2001, which would establish directives for basic sanitation services. This proposed legislation, when and if approved, would establish a new federal regulatory authority for our industry that may, in part, preempt the existing state regulatory authorities under which we operate.

The proposed new legislation and regulatory regime may grant to the new regulatory authorities the power to deny renewals of our concessions after they expire or to cancel existing ones. In addition, the proposed new legislation would modify the way we charge for our water and sewage services businesses as well as our capital expenditure program.

Any of these changes, if they were to occur, could have an adverse effect on our revenues, by causing us to lose concessions we currently hold, or on our operating margins, by limiting our ability to pass our costs on to our customers.

Under the proposed new legislation, the State would continue to be the ultimate concession-granting authority for metropolitan areas. There have been discussions, however, to introduce changes to the proposed legislation by which the State would share the authority with municipalities comprising the metropolitan area. These changes, if adopted, could negatively affect our operations in the São Paulo Metropolitan Region as well as other metropolitan areas which we serve.

As of the date of this annual report, the proposed new legislation has not been voted on by the Brazilian Federal Congress or been sent to the Brazilian Senate for debate. Accordingly, we cannot anticipate when, or if, Law Project No. 4,147 will become legislation.

***We may become subject to substantial water- and sewage-related charges imposed by governmental water agencies of the State of São Paulo and of the Federal Government.***

Governmental water agencies of the State of São Paulo may be, and the Federal Government is, authorized to collect fees from persons, including Sabesp, that either abstract water from, or dump sewage into, water resources controlled by these agencies. The fees collected by these agencies are to be used to develop new water resources and to maintain existing water resources and may be loaned or provided as grants or subsidies to governmental agencies and corporations, including Sabesp, for use in the development and maintenance of water resources. The State legislature of the State of São Paulo is currently debating new legislation that would establish procedures for the collection of these fees. The Federal Government recently enacted legislation under which we must pay fees to the Federal Government or an agency in respect of the use of water from specified sources. We are uncertain as to the likely fees that may be assessed, or whether we will be able to pass on the cost of any of these fees to our customers.

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

We do not hold formal concessions in the City of São Paulo, which accounts for a substantial majority of our sales and services rendered, or in 42 other municipalities in the State of São Paulo. We believe, however, that we have a vested, or implied, right to provide water and sewage services in these municipalities based upon, among other things, our ownership through our predecessor entities of the water and sewage systems serving the City of São Paulo and these other municipalities and certain rights of succession resulting from the merger of state governmental agencies and the state-controlled companies which formed Sabesp in 1973 that were involved in providing water and sewage services in the City of São Paulo and these other municipalities. Because we do not hold concessions or formal contract rights to provide services in these municipalities, we may not be able to effectively enforce our right to continue to provide services or to be paid for the services we provide. In the future, our rights in respect of the City of São Paulo and these other municipalities could be modified or adversely affected by Brazilian federal, state or local governmental actions or other factors, including the enactment of the law contemplated by Law Project No. 4,147.

From time to time mayors of the City of São Paulo, including the present mayor, have initiated or proposed discussions with the State of São Paulo regarding entering into a formal concession contract with Sabesp to provide water and sewage services in the City of São Paulo. The City of São Paulo legislature is also debating new legislation that would establish procedures for granting and monitoring formal concessions for water and sewage services in the City of São Paulo. We cannot assure you as to whether or when any formal concession would be granted by the City of São Paulo, or the terms of any concession contract.

***Municipalities for which we hold concessions may choose not to renew their concessions.***

We provide water and sewage services in 323 municipalities pursuant to concessions granted by the municipalities. Substantially all of these concessions have 30-year terms: 273 of these concessions expire between 2004 and 2010; and the rest expire between 2011 and 2030. Each of these concessions is automatically renewable for a period equal to its initial term, unless we or the municipality exercise the right to terminate the concession prior to the six-month period ending on the expiration date of the concession. If a substantial number of these municipalities choose not to renew their concessions, it could adversely affect our revenues and cash flows.

***Municipalities may terminate our concessions for any "good public reason" or if we fail to meet our contractual obligations.***

Municipalities may terminate our concessions under some circumstances, including if we fail to comply with our obligations under the relevant concession contracts. In addition to contractual termination provisions in concession contracts, municipalities have the inherent power under Brazilian law to terminate concessions prior to their contractual expiration dates for any "good public reason." The meaning of "good public reason" has not been defined by Brazilian law or conclusively determined by Brazilian courts. In the event of the termination of a concession, we may receive

inadequate compensation from the concessionaire municipality. We may also incur material litigation costs related to termination of concessions and compensation.

Diadema and Mauá, two municipalities previously served by Sabesp, terminated our concessions in 1995. Legal proceedings are currently pending with respect to the terms of these terminations. In addition, in 1997, the municipality of Santos enacted a law expropriating the water and sewage systems of Sabesp in Santos. In response, we filed an action seeking an injunction against this expropriation which was denied by the lower court. This decision was later reversed by the Court of Appeals of the State of São Paulo, which issued a preliminary order suspending that law. On August 2, 2002, a decision on this matter was rendered in favor of Sabesp by a lower court, but such decision is still subject to appeal, and we cannot assure you that the ultimate determination will be favorable to us. Despite the pending lawsuit, we continue to provide water and sewage services to Santos.

We cannot assure you that other municipalities will not seek to terminate their concessions. Exercise of concession termination rights by substantial numbers of municipalities could have a material adverse effect on our business and results of operations.

***We may experience difficulty in collecting substantial overdue accounts receivable due from municipalities.***

At December 31, 2002, we had accounts receivable totaling R\$565.0 million from municipalities to which we provide water on a bulk basis. Of this amount, we estimate that approximately R\$93.7 million was between 90 and 360 days overdue and R\$420.9 million was more than 360 days overdue. The Brazilian courts have required that we continue to provide water on a bulk basis to municipalities, even if they fail to pay our invoices. Although we have entered into negotiations with municipalities to reschedule such accounts receivable and have also filed legal proceedings against municipalities to collect the overdue amounts, some municipalities are currently not paying our invoices in full or on a timely basis. In addition, some governmental entities located in municipalities we serve are also not paying us on a current basis. We cannot assure you as to whether or when these municipalities will resume making current payments or pay overdue amounts owing to us. If these municipalities do not pay amounts they owe us, our cash flows, results of operations and financial condition will be adversely affected.

***Our financial performance will be adversely affected if we are unable to increase customer tariffs in line with increases in inflation and operating expenses.***

Our results of operations and financial condition are highly dependent upon our ability to set and collect adequate tariffs for our water and sewage services. Although we generally have broad power to establish tariffs, this power is, in practice, subject to political and legal constraints. Since 1995, we generally have been able to raise tariffs yearly in line with increases in inflation or operating expenses and to support our liquidity and capital resource requirements. However, during this period we did not raise our tariffs from mid-1999 until mid-2001, due to a State policy of not increasing tariffs for public services. In 2001, we raised tariffs in line with the consumer price inflation rates in Brazil since mid-1999. In August 2002, we raised tariffs in line with consumer price inflation rates in Brazil since mid-2001. We will continue to rely upon tariff revenues, among other things, to provide funds for our capital expenditure program and to meet our debt service requirements. Any failure to establish or maintain tariffs commensurate with these and our other needs could have an adverse effect on our results of operations and financial condition.

***We have substantial liquidity and capital resource requirements, and any failure to obtain new financing may have a material adverse effect on the operation and development of our business.***

Our capital expenditure program calls for expenditures of approximately R\$3.9 billion in the period from 2003 through 2007, including approximately R\$656.0 million in 2003 and R\$825.0 million in 2004. We plan to fund these expenditures and our other liquidity and capital resource needs out of funds generated by operations and domestic and foreign currency borrowings on acceptable terms.

We cannot assure you that we will be able to obtain sufficient funds to complete our capital expenditure program or satisfy our other liquidity and capital resources requirements. Failure to obtain the requisite funds could delay or prevent completion of our capital expenditure program and other projects, which may have a material adverse effect on the operation and development of our business.

***Brazilian regulations as well as contractual provisions may limit our ability to incur indebtedness in the future.***

Brazilian regulations provide that a state-owned company, such as Sabesp, may only use the proceeds of "external credit operations" (i.e., foreign currency borrowings) to refinance outstanding financial obligations. These regulations do not apply to import financing and financing transactions involving multilateral organizations, such as the World Bank and the Inter-American Development Bank. As a result of these regulations, our ability to incur foreign currency-denominated debt is limited.

Under our existing debt instruments, we are subject to covenants limiting our ability to incur additional indebtedness, whether denominated in *reais* or foreign currency. Under these covenants, we would have been able to borrow up to an additional R\$180.7 million at December 31, 2002. If, however, these and other limitations restrict our ability to borrow, we may be unable to satisfy all of our liquidity and capital resources requirements, which could have a material adverse effect on our business.

***Droughts may result in major shortages in our water supply, which may have a material adverse effect on our company.***

We experience decreases in our water supply from time to time due to droughts. Brazil recently experienced a prolonged and severe drought, which commenced in 1999 and ended in 2001. As a result of this drought, our volume of water billed decreased and our costs increased as a result of additional capital expenditures required to alleviate the effects of this drought on our water production systems. We cannot assure you that any drought will not materially adversely affect our water supply and, accordingly, our business and results of operations.

***A Brazilian electrical energy crisis could adversely affect our financial condition and results of operations.***

Brazil experienced a severe shortage of capacity to generate and transmit electrical power during 2001, primarily due to the prolonged and severe drought which negatively affected the hydroelectric generation of power as well as to a lack of investment in power generation. In May 2001, the Federal Government announced measures aimed at an average reduction of 20% in electricity consumption in a number of regions of Brazil, including areas in which we operate. However, the operations of companies that render "essential services," such as companies like Sabesp that render water and sewage services, were not subject to these measures. As a result of higher water levels in reservoirs as well as steps taken by the Brazilian government to increase the amount of available electrical power, the Brazilian government eliminated all electricity consumption restrictions as of March 2002.

Because water production, treatment and distribution and sewage collection, treatment and disposal demand a significant consumption of electric energy, a substantial shortage or lack of electrical energy could result in a temporary interruption of our services. In addition, due to electricity conservation measures, our customers curtailed their use of our water services, resulting in a lower volume of water and sewage billed during the electrical energy crisis.

***Potential costs of environmental compliance as well as potential environmental liability may have a material adverse effect on our company.***

Our facilities are subject to many Brazilian federal, state and local laws and regulations relating to the protection of human health and the environment. We have made, and will continue to make, substantial expenditures to comply with these provisions. In addition, because environmental laws and their enforcement are becoming more stringent, our capital expenditures and expenses for environmental compliance may increase substantially in the future. The amount of investments that we make in any given year is subject to limitations by the State Government. Expenditures required for compliance with environmental regulation may result in reductions in other strategic investments that we have planned, which could negatively affect our profitability. We could also be exposed to criminal and administrative penalties, in addition to indemnification obligations, for eventual damage for non-compliance with environmental laws and regulations. Any material unforeseen environmental costs and liabilities may have a material adverse effect on our future financial performance.

***We may be required to compete through a public bidding process in order to obtain new or renew existing concessions.***

Substantially all of our concessions were granted without a public bidding process. Under current Brazilian Federal and State law, however, for any new concession, we may be required to participate in a bidding process. In addition, if a public entity from which we hold a concession granted prior to the enactment of the concession laws determines that in order to comply with such laws it must engage in a public bidding process, we could be required to compete in order to renew our existing concession. While in certain cases we may be able to obtain concessions without participating in a bidding process, we cannot assure you that the Brazilian courts will continue to interpret the concessions laws to permit municipalities to grant concessions without a public bidding process or that we will be able to secure all new water and sewage concessions that we may wish to obtain.

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

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, tax, labor, condemnation and other proceedings. A substantial monetary judgment against us in one or more of these legal proceedings may have a material adverse effect on our business or financial condition.

We are party to various tax proceedings, including, among others, legal actions we initiated to challenge certain federal and municipal tax laws. We have not provisioned any amounts for the actions we have initiated. In addition, on May 28, 1999, we filed a lawsuit challenging a 1998 law which expanded the definition of revenue subject to PASEP taxes and increased the COFINS rate. Pending resolution of this proceeding, we have obtained a preliminary injunction providing protection against fines as we pursue the claim, as we are not paying the tax under the terms set by the 1998 law. As of December 31, 2002, we had provisioned approximately R\$170.5 million with respect to this lawsuit.

In addition, the labor proceedings in which we are involved include two lawsuits filed against us by the Sindicato dos Trabalhadores em Água, Esgoto e Meio Ambiente de São Paulo (the São Paulo Water, Sewage and Environment Service Workers Union, or SINTAEMA). In each of these suits, SINTAEMA has alleged that we failed to pay our employees amounts we were required to pay. We are also party to a large number of other lawsuits and administrative proceedings involving SINTAEMA and our present and former employees. At December 31, 2002, we established a provision totaling R\$19.1 million with respect to potential damages in lawsuits and administrative proceedings involving present and former employees, including the SINTAEMA lawsuits.

We are also party to a significant number of condemnation proceedings arising from our partial or total expropriation or use of private property for water mains, sewer lines and facilities. At December 31, 2002, we estimated that we will be required to make payments totaling R\$56.4 million with respect to all pending condemnation matters, which will be recorded as fixed assets upon payment.

The State Prosecutor's Office of the State of São Paulo has also initiated a number of legal actions to challenge our handling and treatment of waste in various water basins. In each of these disputes, the State Prosecutor's Office has sought an injunction requiring us to treat sewage before releasing it into water basins and to abstain from collecting tariffs for sewage collection as long as we fail to treat the sewage collected. If we were required to abstain from collecting tariffs for sewage collection with respect to these water basins, our revenues could be adversely affected. If we were required to treat the sewage as requested by the State Prosecutor's Office, we would generally need to build new sewage treatment plants or significantly expand capacity at existing sewage treatment plants, which would require significant additional capital expenditures. Any significant unanticipated capital expenditures may have a material adverse effect on our ability to make planned capital expenditures and on our profitability.

***Because we are not insured for all business- and environmental-related contingencies, the occurrence of any such contingency may have a material adverse effect on our future financial performance.***

We do not have insurance coverage for business interruption risk or for liabilities arising from contamination or other problems involving our water supply to customers. In addition, we do not have insurance coverage for liabilities relating to non-compliance with environmental laws and regulations relating to our sewage services. As a result, any major business interruption or environmental-related liability may have a material adverse effect on our future financial performance.

#### ***Risks Relating to Brazil***

***Brazilian economic, political and other conditions may have a material adverse effect on our company.***

The Brazilian economy has been characterized by significant involvement on the part of the Brazilian government, which often changes monetary, credit and other policies to influence Brazil's economy. The Brazilian government's actions to control inflation and affect other policies have often involved wage and price controls, the Central Bank's base interest rates, as well as other measures, such as the freezing of bank accounts, which occurred in 1990.

Actions taken by the Brazilian government concerning the economy may have important effects on Brazilian corporations and other entities, including Sabesp, and on market conditions and prices of Brazilian securities, including our equity and debt securities. Our financial condition and results of operations may be adversely affected by, as well as the Brazilian government's response to, the following factors:

- devaluations and other exchange rate movements;
- inflation;
- exchange control policies;
- social instability;
- price instability;
- energy shortages;
- interest rates;



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- liquidity of domestic capital and lending markets;
- tax policy; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Brazil's President, Luiz Inacio Lula da Silva, was elected in October 2002 and took office on January 1, 2003. We cannot predict the effect that the policies of the Lula administration may have on Brazilian economic conditions or on our financial condition or results of operations. The Lula administration has announced that it expects to implement reforms in the Brazilian social security and welfare systems to address underfunding and in Brazil's tax and bankruptcy laws. To date, no significant legislative or regulatory changes have been made by the Brazilian government. Future developments or non-developments in the Brazilian economy and government policies may adversely affect our financial condition and results of operations, and impact the market price of our debt and equity securities.

***A devaluation of the real could adversely affect our ability to service our foreign currency-denominated debt, and could lead to a decline in the market price of our common shares and ADSs.***

The Brazilian currency has been devalued frequently during the last four decades. Throughout this period, the Brazilian government has implemented various economic plans and utilized various exchange rate policies, including sudden devaluations, periodic mini-devaluations (during which the frequency of adjustments has ranged from daily to monthly), exchange controls, multiple exchange rate markets and floating exchange rate system. From time to time, there have been significant fluctuations in the exchange rates between the Brazilian currency and the U.S. dollar and other currencies. For example, in 1999, 2000, 2001 and 2002, the *real* devalued 32.4%, 8.5%, 15.7% and 34.3% against the U.S. dollar.

In the event of a significant devaluation of the *real* in relation to the U.S. dollar or other currencies, our ability to meet our foreign currency-denominated obligations could be adversely affected, particularly as our tariff revenues and other sources of income are based solely in *reais*. In addition, because we have substantial foreign currency-denominated indebtedness, any significant devaluation of the *real* during a financial period will increase our financial expenses as a result of foreign exchange losses that we must record. We had total foreign currency-denominated indebtedness of R\$3,708.0 million at December 31, 2002, and we anticipate that we may incur substantial amounts of foreign currency-denominated indebtedness in the future. For example, our financial expenses and our overall results of operations for 2002 were significantly negatively affected by the 34.3% devaluation of the *real* in 2002.

A devaluation would reduce the U.S. dollar value of distributions and dividends on our ADSs and could reduce the market price of our common shares and ADSs.

***The Brazilian government's actions to combat inflation and public speculation about possible future action may contribute significantly to economic uncertainty in Brazil and cause the price of our equity and debt securities to fall.***

Historically, Brazil experienced high rates of inflation. Inflation itself, as well as the governmental efforts to combat inflation, has had significant negative effects on the Brazilian economy in general. Inflation, action taken to combat inflation and public speculation about possible future action has also contributed materially to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets.

Inflation, as measured by the *Índice Geral de Preços de Mercado* (the General Price Index-Market, or the IGP-M), was 1.8% in 1998, 20.1% in 1999, 10.0% in 2000, 10.4% in 2001 and 25.3% in 2002. There can be no assurance that levels of inflation in Brazil will not increase in future years and have a material adverse effect on our business, financial condition, results of operations or prospects.

If Brazil experiences significant inflation in the future, our costs and expenses may rise, we may be unable to increase our tariffs to counter the effects of inflation, and our overall financial performance may be adversely affected. In addition, a substantial increase in inflation may weaken investor confidence in Brazil, so that the market price of our equity and debt securities declines.

***Brazilian law might permit claims against our shareholders for harm to the environment.***

Brazilian Law No. 9,605 of February 12, 1998 provides that the corporate structure of a company may be disregarded if it impedes recovery for undue harm to the environment. We cannot assure you that, in the case of claim for environmental damage under this law, liabilities would be limited to shareholders capable of exercising control over the company at the time of the environmental damage. Accordingly, if we were unable to redress claims against us for environmental damages, which might happen, for example, if we were to become insolvent, our shareholders and the members of our management might become liable for those claims. We are not aware of any successful assertion of

claims against any shareholders of any other Brazilian corporation under this law and cannot predict the circumstances in which this might happen.

**Risks Relating to our Common Shares and ADSs**

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

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

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

***If a holder exchanges ADSs for common shares, he or she risks losing the ability to remit foreign currency abroad and Brazilian tax advantages.***

The Brazilian custodian for the common shares underlying our ADSs must obtain a certificate of registration from the Central Bank to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to our common shares or upon our disposition of our common shares. If a holder decides to exchange his or her ADSs for the underlying common shares, he or she will be entitled to continue to rely – for five business days from the date of exchange – on the custodian's certificate of registration. After that period, the holder may not be able to obtain and remit U.S. dollars abroad upon the disposition of our common shares, or distributions relating to our common shares, unless he or she obtains his or her own certificate of registration or register under Resolution No. 2,689, of January 26, 2000, of the National Monetary Council, which entitles registered foreign investors to buy and sell on the Brazilian stock exchanges. If the holder does not obtain a certificate of registration or register under Resolution No. 2,689, he or she will generally be subject to less favorable tax treatment on gains with respect to our common shares.

If a holder attempts to obtain his or her own certificate of registration, he or she may incur expenses or suffer delays in the application process, which could delay his or her ability to receive dividends or distributions relating to our common shares or the return of his or her capital in a timely manner. We cannot assure you that the custodian's certificate of registration or any foreign capital registration obtained by a holder may not be affected by future legislative changes, or that additional restrictions applicable to the holder, the disposition of the underlying common shares or the repatriation of the proceeds from disposition will not be imposed in the future.

***The relative volatility and illiquidity of the Brazilian securities market may substantially limit a holder's ability to sell the common shares underlying our ADSs at the prices and time he or she desires.***

The Brazilian securities markets are substantially smaller, less liquid, more concentrated and more volatile than major securities markets in the United States and other jurisdictions, and are not as highly regulated or supervised as some of these other markets. The relatively small market capitalization and illiquidity of the Brazilian equity markets may substantially limit a holder's ability to sell the common shares underlying our ADSs at the price and time he or she desires.

***A holder of common shares or ADSs may face difficulties in protecting his or her interests as a shareholder, because we are subject to different corporate rules and regulations as a Brazilian company and holders have fewer and less well-defined shareholders' rights.***

Our corporate affairs are governed by our by-laws and the Brazilian corporation law, which differ from the legal principles that would apply if we were incorporated in a jurisdiction in the United States, such as the State of Delaware or the State of New York, or in other jurisdictions outside Brazil. In addition, the rights of holders of our ADSs or common shares under the Brazilian corporation law to protect their interests relative to actions by our Board of Directors may be fewer and less well-defined than under the laws of those other jurisdictions.

Although insider trading and price manipulation are crimes under Brazilian law, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets or markets in some other jurisdictions. In addition, rules and policies against self-dealing and regarding the preservation of shareholder interests may be less well-defined and enforced in Brazil than in the United States, putting holders of our common shares and ADSs at a potential



disadvantage. Corporate disclosures may be less complete or informative than what may be expected of a U.S. public company.

***A holder of common shares or ADSs may face difficulties in protecting his or her interests as a shareholder because we are a Brazilian company.***

We are a mixed capital company (*sociedade de economia mista*) organized under the laws of Brazil, and all of our directors and officers and our controlling shareholder reside in Brazil. All of our fixed assets and those of these other persons are located in Brazil. As a result, it may not be possible for a holder to effect service of process upon us or these other persons within the United States or other jurisdictions outside Brazil or to enforce against us or these other persons judgments obtained in the United States or other jurisdictions outside Brazil. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain requirements are met, a holder may face difficulties in protecting his or her interests in the case of actions by our directors, officers or our controlling shareholder than would shareholders of a corporation incorporated in a state or other jurisdiction of the United States. In addition, under Brazilian law, none of our assets which are essential to our ability to render public services are subject to seizure or attachment. Furthermore, the execution of a judgment against our controlling shareholder may be delayed as payment of such judgment must be made pursuant to the State's budget in a subsequent fiscal year. None of the public property of our controlling shareholder is subject to execution or attachment, either prior to or after judgment.

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

Sales of a substantial number of our common shares—or the anticipation of such sales—could decrease the trading price of our common shares and ADSs. As of April 30, 2003, we had 28,479,577,827 common shares outstanding, including 20,376,674,058 shares held by the State of São Paulo. As a consequence of the issuance of common shares or sales by the State of São Paulo or other existing shareholders, the market price of our common shares and, by extension, our ADSs may decrease significantly. As a result, a holder may not be able to sell his or securities at or above the price he or she paid for them.

***A holder of ADSs might be unable to exercise preemptive rights with respect to the common shares underlying our ADSs.***

A holder may not be able to exercise the preemptive rights relating to the common shares underlying his or her ADSs unless a registration statement under the U.S. Securities Act of 1933 is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to our common shares relating to these preemptive rights, and we cannot assure you that we will file any such registration statement. Unless we file a registration statement or an exemption from registration is available, a holder may receive only the net proceeds from the sale of his or her preemptive rights by the depositary or, if the preemptive rights cannot be sold, they will be allowed to lapse.

***A non-Brazilian holder of our ADSs may find it more difficult than our Brazilian shareholders do to exercise his or her voting rights at our shareholders' meetings.***

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

***Developments in other emerging market countries, including Argentina, may adversely affect the Brazilian economy and, therefore, the market prices of our common shares and ADSs, as well as of our debt securities.***

In the past, the Brazilian economy and the securities of Brazilian companies have been, to varying degrees, influenced by economic and market conditions in other emerging market countries, particularly in Latin America, as well

as investors' responses to those conditions. In particular, the ongoing financial crisis in Argentina may affect the economy in Brazil, as both a neighboring country and a significant trading partner.

In addition, although economic conditions are different in each country, investors' reactions to adverse developments in one country may affect the market price of securities of issuers in other countries, including Brazil. For example, the 1997 Asian economic crisis and the 1998 Russian debt moratorium and devaluation of the Russian currency triggered market volatility in Latin America and securities markets in other emerging market countries. Accordingly, adverse developments in Argentina or in other emerging market countries could lead to a reduction in the demand for, and market prices of, our common shares and ADSs, as well as our debt securities.

#### ITEM 4. INFORMATION ON THE COMPANY

##### General

Companhia de Saneamento Básico do Estado de São Paulo-SABESP is a *sociedade de economia mista*, a mixed capital company with limited liability of unlimited duration, duly organized and operating under the Brazilian corporation law. Our principal executive offices are located at Rua Costa Carvalho, 300, 05429-900 São Paulo, SP, Brazil. Our telephone number is (55-11) 3388-8000. Our agent for services of process in the United States is CT Corporation System, with offices at 111 Eighth Avenue, New York, New York 10011. As set forth in Article 2 of our by-laws, our corporate purpose is to plan, execute, and operate basic sanitation services throughout the territory of the State of São Paulo, including the capture, collection, processing and distribution of water, as well as the collection, removal, processing and final disposal of sewage and sludge.

We believe we are one of the largest water and sewage companies in the Americas based upon net revenues in 2002. We operate public water and sewage systems in the State of São Paulo in which the City of São Paulo, Brazil's largest city, is located. According to the Brazilian Institute of Geography and Statistics, or IBGE, the State of São Paulo is Brazil's most populous and economically productive state. We had net operating revenue of R\$3,767.1 million (US\$1,066.2 million) and net loss of R\$650.5 million (US\$184.1 million) in 2002. We had total assets of R\$16,331.9 million (US\$4,622.3 million) and shareholders' equity of R\$7,246.5 million (US\$2,050.9 million) at December 31, 2002.

We provide water and sewage services to a broad range of residential, commercial, industrial and governmental customers in the City of São Paulo and in 365 of the 645 other municipalities in the State of São Paulo. We also supply water on a bulk basis to municipalities in the São Paulo Metropolitan Region in which we do not operate water systems. We divide our service territories into three regions: the São Paulo Metropolitan Region, the Interior Region, and the Coastal Region. The São Paulo Metropolitan Region, the Interior Region and the Coastal Region accounted for 76%, 16% and 8% of our sales and services rendered in 2002.

At December 31, 2002, we distributed water to approximately 21.2 million persons, which we believe includes approximately 60% of the urban population of the State of São Paulo, through approximately 54.3 thousand kilometers of water pipes and mains to more than 5.9 million water connections. We provided sewage services to approximately 16.8 million persons, or 79% of our water customers, through approximately 34.4 thousand kilometers of sewer lines to approximately 4.3 million sewage connections. In addition, we sell water in bulk to seven other municipalities having an estimated population of approximately 3.8 million.

The State of São Paulo, our controlling shareholder, is required by State law to own at least two-thirds of our common (voting) shares. At April 30, 2003, approximately 71.5% of our outstanding common shares was owned by the State of São Paulo. As a state-controlled company, we are an integral part of the governmental structure of the State of São Paulo. Our strategy and major policy decisions are formulated in conjunction with the Energy, Water Resources and Sanitation Secretariat of the State of São Paulo as part of the overall strategic planning for the State of São Paulo. The members of the Board of Directors and the Executive Committee of Sabesp are nominated by the Conselho de Defesa de Capitais do Estado de São Paulo-CODEC (State Council for Protection of Capital of the State of São Paulo), a State agency presided over by the Secretary of the State Treasury and reporting directly to the Governor.

In addition, our capital expenditure budget is subject to approval by the State Legislature and is approved in conjunction with the budget of the Energy, Water Resources and Sanitation Secretariat and of the State of São Paulo as a whole. However, the Governor of the State of São Paulo has the power to modify our capital expenditure budget after it has been approved. Our financial statements and accounting records are subject to review by the Tribunal de Contas (State Accounts Tribunal), as are all accounts of the State of São Paulo.

##### State of São Paulo

The State of São Paulo is one of 26 states that, together with the Federal District of Brasília, constitute the Federative Republic of Brazil. The State is located in the southeastern region of the country, which is, according to IBGE, the most developed and economically active region of Brazil, which includes the states of Minas Gerais, Espírito Santo and Rio de Janeiro. The State lies between the states of Rio de Janeiro and Minas Gerais to the north, the state of Paraná to the south, Mato Grosso do Sul to the west and the Atlantic Ocean to the east.

The State of São Paulo occupies 3% of Brazil's land mass and encompasses an area totaling approximately 96,000 square miles. According to IBGE, the State is the most populous state in Brazil, with an estimated population at December 31, 2002 of 38.4 million.