The following tables set forth the selling rate, expressed in *reais* per Japanese Yen (R$/¥1.00):

	R$ per ¥1.00			
Year ended December 31,	**Year end**	**Average(1)**	**High**	**Low**
2008	0.0258	0.0180	0.0272	0.0144
2009	0.0188	0.0213	0.0268	0.0186
2010	0.0205	0.0201	0.0212	0.0183
2011	0.0243	0.0211	0.0249	0.0186
2012	0.0237	0.0245	0.0263	0.0211

	R$ per ¥1.00			
Month ended	**Period end**	**Average(1)**	**High**	**Low**
October 31, 2012	0.0255	0.0255	0.0259	0.0252
November 30, 2012	0.0237	0.0248	0.0257	0.0237
December 31, 2012	0.0218	0.0228	0.0235	0.0218
January 31, 2013	0.0214	0.0212	0.0216	0.0209
February 28, 2013	0.0214	0.0209	0.0214	0.0203
March 31, 2013	0.0205	0.0206	0.0218	0.0199
April 30, 2013	0.0205	0.0205	0.0218	0.0199
May 2013 (through May 8, 2013)	0.0203	0.0203	0.0205	0.0203

Source: Central Bank

(1) Average of the exchange rates on the last day of each period.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Risks Relating to Brazil

The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This influence, as well as Brazilian political and economic conditions, could adversely affect us and the market price of our common shares and ADSs.

The Brazilian government frequently intervenes in the Brazilian economy and occasionally makes significant changes in policy and regulations. The Brazilian government's actions to control inflation and other policies and regulations have often involved, among other measures, changes in interest rates, tax policies, price and tariff controls, currency devaluation or appreciation, capital controls and limits on imports. Our business, financial condition and results of operations, as well as the market price of our common shares or ADSs, may be adversely affected by changes in public policy at federal, state and municipal levels with respect to public tariffs and exchange controls, as well as other factors, such as:

- the regulatory environment related to our business operations and concession agreements;
- interest rates;
- exchange rates and exchange controls and restrictions on remittances abroad;
- currency fluctuations;
- inflation;
- liquidity of the Brazilian capital and lending markets;
- tax and regulatory policies and laws;
- economic and social instability; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

For example, the Brazilian government may change its tax policy, such as changing tax rates or imposing temporary taxes. If overall taxes are increased, we may be unable to immediately recover the difference from our consumers, which may have an adverse effect on our financial condition and results of operations.

Uncertainty over whether the Brazilian government will implement changes in policies or regulations affecting these factors or others may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities market and in securities issued abroad by Brazilian issuers, which could have a material adverse effect on us and on our common shares and ADSs.

Inflation and the Brazilian government's measures to combat inflation may contribute to economic uncertainty in Brazil, adversely affecting us and the market price of our common shares or ADSs.

Brazil has experienced extremely high rates of inflation in the past. Inflation and the Brazilian government's measures to combat inflation have had significant negative effects on the Brazilian economy, contributing to economic uncertainty and heightened volatility in the Brazilian securities market. The Brazilian government's measures to control inflation have often included maintaining a tight monetary policy with high interest rates, thereby restricting the availability of credit and reducing economic growth. The Special Clearing and Settlement System (*Sistema Especial de Liquidação e Custódia*), or SELIC, the official overnight interest rate in Brazil, equaled 7.14%, 10.91% and 10.66% at the end of 2012, 2011 and 2010, respectively, in line with the target rate set by the Brazilian Committee on Monetary Policy (*Comitê de Política Monetária*).

The annual rate of inflation, as measured by the General Market Price Index (*Índice Geral de Preços—Mercado*), or IGP-M index, fell from 9.95% in 2000 to 3.83% in 2006, increased to 7.75% in 2007 and further increased to 9.81% in 2008. According to the IGP-M index, Brazil underwent deflation of 1.71% in 2009, followed by inflation of 7.81%, 5.1% and 11.32% in 2012, 2011 and 2010, respectively. Brazilian governmental actions, including interest rate decreases, intervention in the foreign exchange market and actions to adjust or fix the value of the *real*, may trigger increases in inflation. If Brazil experiences high inflation again, 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 investors' confidence in Brazil, causing a decrease in the market price of our common shares or ADSs.

Additionally, in the event of an increase in inflation, the Brazilian government may choose to raise official interest rates. Increases in interest rates would not only affect our cost of funding, but could also have a material adverse effect on us and may also adversely affect the market price of our common shares or ADSs.

Exchange rate instability may adversely affect us and the market price of our common shares or ADSs.

The Brazilian currency experienced frequent and substantial devaluations in relation to the U.S. dollar and other foreign currencies during the decades leading up to the mid-1990s. Throughout this period, the Brazilian government implemented various economic plans and exchange rate policies, including sudden devaluations, periodic mini-devaluations (during which the frequency of adjustments ranged from daily to monthly), floating exchange rate systems, exchange controls and dual exchange rate markets. From time to time since that period, there have continued to be significant fluctuations in the exchange rate between the Brazilian *real* and the U.S. dollar and other currencies. For example, the *real* appreciated 13.8%, 9.5% and 20.7% against the U.S. dollar in 2005, 2006 and 2007, respectively. In 2008, primarily as a result of the global financial crisis, the *real* depreciated 32.0% against the U.S. dollar and closed the year at R$2.337 per US$1.00. The *real* strengthened again by 25.5% in 2009 and 4.3% in 2010, but depreciated against the U.S. dollar by 12.6% in 2011 and 8.94% in 2012. On December 31, 2012, 2011 and 2010, the *real*/U.S. dollar exchange rate was R$2.043, R$1.876 and R$1.666 per US$1.00, respectively. There can be no assurance that the *real* will not depreciate further against the U.S. dollar. As of April 23, 2013, the commercial selling rate as reported by the Central Bank was R$2.0435 per US$1.00.

Depreciation of the *real* against the U.S. dollar could create inflationary pressures in Brazil and cause increases in interest rates, which could negatively affect the growth of the Brazilian economy as a whole and harm our financial condition and results of operations, curtail our access to financial markets and prompt government intervention, including recessionary governmental policies. Depreciation of the *real* against the U.S. dollar could also lead to decreased consumer spending, deflationary pressures and reduced growth of the economy as whole.

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 because our tariff revenue and other sources of income are denominated solely in *reais*. In addition, because we have debt denominated in foreign currencies, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. We had a total foreign currency denominated debt of R$3,215.8 million as of December 31, 2012 and we anticipate that we may incur substantial additional amounts of foreign currency denominated debt in the future. In 2012, our results of operations were negatively affected by the 8.94% depreciation of the *real* against the U.S. dollar, and an appreciation of the real against the yen by 2.43% which led to a R$50.5 million negative impact on our foreign exchange result, net. We do not currently have any derivative instruments in place to protect us against a devaluation of the *real* in relation to any foreign currency. A devaluation of the *real* may adversely affect us and the market price of our common shares or ADSs.

Developments and the perception of risk in other countries, especially in the United States and in emerging market countries, may adversely affect the market price of Brazilian securities, including our common shares and ADSs.

The market price of securities of Brazilian companies is affected to varying degrees by economic and market conditions in other countries, including the United States and other Latin American and emerging market countries. Although economic conditions in these countries may differ significantly from economic conditions in Brazil, investors' reactions to developments in these other countries may have an adverse effect on the market price of securities of Brazilian issuers. Crises in other emerging market countries or economic policies of other countries may diminish investor interest in securities of Brazilian issuers, including ours. This could adversely affect the market price of our common shares or ADSs, and could also make it more difficult for us to access the capital markets and finance our operations in the future, on acceptable terms or at all.

The global financial crisis has caused significant consequences, including in Brazil, such as stock and credit market volatility, unavailability of credit, higher interest rates, a general slowdown of the world economy, volatile exchange rates, and inflationary pressure, among others, which have and may continue to, directly or indirectly, materially and adversely affect us and the price of securities issued by Brazilian companies, including our common shares and ADSs.

Risks Relating to Our Control by the State of São Paulo

We are controlled by the State of São Paulo, whose interests may differ from the interests of non-controlling, including holders of ADSs.

As it owns the majority of our common shares, the State of São Paulo is able to determine our operating policies and strategy, control the election of a majority of the members of our board of directors and appoint our senior management. As of April 23, 2013, the State owned 50.3% of our outstanding common shares.

Both through its control of our board of directors as well as by enacting State decrees, the State has in the past directed our company to engage in business activities and make expenditures that promoted political, economic or social goals but that did not necessarily enhance our business and results of operations. The State may direct our company to act in this manner again in the future. These decisions by the State may not be in the interests of our non-controlling, including holders of ADSs. See "Item 5.A. Operating and Financial Review and Prospects—Certain Transactions with Controlling Shareholder."

Following the elections for State governor in 2010, the new governor appointed Ms. Dilma Seli Pena as our chief executive officer in 2011, and Mr. Edson de Oliveira Giriboni, the Secretary of State for the State Secretariat for Sanitation and Water Resources (*Secretaria de Saneamento e Recursos Hídricos do Estado de São Paulo*), was elected as chairman of our board of directors. Future changes in policy by State government may cause changes in all or some of the members of our management, which may have a material adverse effect on our business and results of operations.

The State and some State entities owe us substantial unpaid debts. We cannot assure you as to when or whether the State will pay us.

Historically, the State and some State entities have delayed payment of substantial amounts owed to us related to water and sewage services. Aditionally, the State also owes us substantial amounts related to reimbursements of 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. As of December 31, 2012, the State owed us R$65.5 million for water and sewage services. With respect to payment of pensions on behalf of the State, we had a non-contested reimbursement in the amount of R$196.9 million as of December 31, 2012 for actuarial liability, and a contested amount of R$1,351.2 million as of the same date. We do not record this contested amount as a reimbursement for actuarial liability due to the uncertainty of payment by the State. In addition, as of December 31, 2012, we had a provision for an actuarial liability in the amount of R$1,547.2 million in respect of future supplemental pension payments the State does not accept responsibility for paying. The amounts owed to us by the State for water and sewage services and reimbursements for pensions paid may increase in the future.

We have entered into agreements with the State to settle the overdue amounts that relate to water and sewage services. For a detailed discussion of these agreements, see "Item 7.B. Related Party Transactions, Agreements with the State of São Paulo" and Note 8 of our consolidated financial statements. Under these agreements, the State agreed that the amounts due with respect to water and sewage services through December 2007 could be settled through the application of dividends payable by us to the State. In December 2007, the State agreed to pay us the outstanding balance as of November 30, 2007 of R$133.7 million in 60 consecutive monthly installments, beginning on January 2, 2008, and an amount of R$236.1 million relating to a portion of the unpaid invoices from March 2004 through October 2007 for water and sewage services. We agreed to pay the State, in the period from January through March 2008, the outstanding balance of dividends owed to it in respect of interest on shareholders' equity in our company from March 2004 through December 2006, in the amount of R$400.8 million.

In March 2008, we entered into a commitment agreement with the State to settle the outstanding debt related to the reimbursement of the pension benefits we paid on the State's behalf. For a detailed discussion of this commitment agreement, see "Item 7.B. Related Party Transactions—Agreements with the State of São Paulo." Under this commitment agreement, we and the State agreed that the amounts owed to us with respect to the pensions we paid on behalf of the State could be partially settled through the transfer of certain reservoirs to us that we use in the Alto Tietê System, which are owned by the State. Following this commitment agreement, in November 2008 we and the State entered into a formal agreement relating to the pension benefits we paid on the State's behalf. Under this agreement, the State acknowledged that it owed us a total of R$915.3 million in this regard as of September 30, 2008, and we provisionally accepted the reservoirs in the Alto Tietê System as partial payment (R$696.3 million) subject to the transfer of the property rights in the reservoirs to us. In November 2008, the State began to pay us the remaining balance of R$219.0 million in 114 monthly installments through to early 2018. However, on October 29, 2003 the Public Prosecutor's Office of the State of São Paulo (*Ministério Público do Estado de São Paulo*) commenced legal proceedings alleging that the transfer of ownership of the Alto Tietê System reservoirs to us would be illegal, on the basis that there is no specific legislative authorization for the transfer. We are unable to predict, however, whether and when these reservoirs will be transferred to us and therefore whether and when we will receive payment or assets equivalent to the R$696.3 million owed. See "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings—Other Legal Proceedings."

In addition to the R$915.3 million that the State acknowledged that it owed us under the November 2008 agreement, we are also negotiating with the State in respect to the further amount that the State does not accept that it owes us. We are not able to assure you that we will be successful in these negotiations. Accordingly, as of December 31, 2012, we have not recorded R$1,351.2 million related to the reimbursement that we believe is due to us for the pension benefits we paid on the State's behalf, but we have recorded R$1.547.2 million in pension obligations.

We cannot assure you when or if the State will pay the remaining overdue amounts it owes us. Due to the State's history of not paying us in a timely manner for water and sewage services, and not reimbursing us in a timely manner for the pension benefits we paid on its behalf, we cannot assure you that the amount of account receivables owed to us by the State and some State entities will not significantly increase in the future.

In addition, certain municipalities and other government entities also owe us money. See "—We may face difficulties in collecting overdue amounts owed to us by municipalities to which we provide water on a wholesale basis and municipal government entities."

A state controlled company that has a concession to produce energy in the Guarapiranga and Billings reservoirs may require us to pay damages for the use of water from these reservoirs.

Empresa Metropolitana de Águas e Energia S.A., or EMAE, may require us to financially compensate them for our use of water from the Guarapiranga and Billings reservoirs, which they view as a loss of electricity that could otherwise be generated and sold. Additionally, payments to EMAE, which we were supposed to have made by a specific deadline, were not made. As such, EMAE has requested compensation from us. In the event water from these reservoirs was no longer made available to us, we would have to bring water in from locations further away, which would increase the risk of not being able to provide adequate service in the region, as well as an increase in water transportation costs.

The majority shareholder of both EMAE and us, the state of São Paulo, may force a resolution regarding the dispute of water use from the Guarapiranga and Billings reservoirs, which may have an adverse affect on our business.

Additionally, in the event we are required to make payments and compensation, our cash position and overall liquidity may be adversely affected.

We may be required to pay substantial charges for the use of reservoirs that are not our property.

We use the Billings and Guarapiranga reservoirs in order to provide water services. We are entitled to withdraw water from these reservoirs under a grant from the State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*), or DAEE. We are not currently charged for the use of these reservoirs and are uncertain as to whether we will continue to be able to use the reservoirs without paying charges, or what the likely fee scale would be if one were imposed. We may also be required to pay additional maintenance and operational costs for our use of these reservoirs. If we were required to pay substantial charges to the owner or additional maintenance or operational costs for our use of these reservoirs, we could be materially and adversely affected.

Risks Relating to Our Business

The Brazilian Basic Sanitation Law is still in the process of implementation and interpretation, and doubts remain as to its full impact on the industry. ARSESP, the regulator, has the function to implement regulations under the Basic Sanitation Law within the State of São Paulo, and is in the process of reviewing, implementing and proposing changes to São Paulo State water and sewage regulations, including potentially significant changes to the tariff methodology and structure applicable to our business. The current regulatory uncertainty, and any of the changes that are currently proposed, may have an adverse effect on our business.

Although Law No. 11,445, or the Basic Sanitation Law, has been in effect since early 2007, the full implementation of a number of its provisions remains subject to regulations that have not yet been published. Federal Decree No. 7,217, which was enacted on June 21, 2010, and Law 11,445 implemented a first series of new principles under the Basic Sanitation Law, including the following:

- for public-public partnership contracts (or program contracts), public hearings must be held with respect to bid announcements, and technical and economic viability studies must be carried out;
- the rights and obligations of customers and service providers, including penalties, are determined by the owner of the public service, not by the regulatory agency;
- the technical and financial viability of the provision of water and sewage services should be determined based on (i) capital contributions necessary to offer the services and (ii) expected revenues from the provision of the service; and
- when a regulated service is to be provided by different service providers, those providers must execute an agreement regulating their respective activities.

We cannot currently anticipate all the effects that the Basic Sanitation Law and the decree will have on our business and operations, if any.

The Basic Sanitation Law requires states to establish independent regulators with the responsibility of monitoring basic sanitation services and regulating tariffs. Federal law No. 11,445/07 and São Paulo State Law No. 1,025/07 established the ARSESP, which regulates and supervises the basic sanitation services that we provide in municipalities that have agreed to come under ARSESP's jurisdiction. For the municipalities that have not yet agreed to come under ARSESP's jurisdiction for which we currently provide basic sanitation services, we determine tariffs based on State Decree 41,446/96. ARSESP has proposed or enacted a number of regulatory changes, including the following:

- In 2008, the tariff adjustment formula was reviewed. In 2009, ARSESP opened the methodology for tariff revisions for public discussion and hearings. In 2010, ARSESP published Resolution No. 156. This resolution established the methodology and general criteria for the valuation of our regulatory asset base to be used for purposes of tariff review processes and auditing. During 2011 and 2012 ARSESP held further public consultations regarding the methodology for tariff revisions, which was finally specified and disclosed in April 2012. In November 2012, ARSESP published a preliminary technical note for public consultation, proposing a preliminary initial maximum average tariff (P0) and efficiency gains factor (X), based on a preliminary evaluation of assets held by us. Following further public consultations, in March 2013 ARSESP published two resolutions, Resolution No. 406 and Resolution No. 407.
- Resolution No. 406 sets out the following: (i) an initial maximum average tariff (P0) and a preliminary asset base value to apply until the conclusion of an external audit of our asset base, resulting in a tariff revision of 2.3509%; (ii) authorizes the repayment to consumers of the regulation and supervision rate of 0.5% immediately after the conclusion of the operational adjustments necessary for the inclusion of this rate in the bills in the municipalities where it will be charged; (iii) ARSESP also establishes an annual tariff adjustment formula, to be implemented during the second tariff cycle, consisting of the IPCA variation (a consumer price index) for the period, adjusted by an efficiency factor designed to transfer a portion of our productivity gains to consumers, and further adjusted to reflect changes in service quality to be defined and applied as of the third year of the second tariff cycle. According to ARSESP's timetable the final maximum average tariff (P0) will be announced in August 2013 after the asset base value presented by us is audited.

- A tariff revision of to a rate of 2.3509% was implemented in April 2013 pursuant to Resolution No. 406. Additionally, we will pass an inspection fee of 0.5% to consumers immediately after the conclusion of the operational adjustments necessary for the inclusion of this rate in the bills to municipalities where it will be charged.

- Resolution No. 407 authorizes us to pass on to the service bill legal charges defined by municipal legislation, which under the Program Contracts and the Sewage and Water Supply Service Contracts must be considered in the tariff revision.

In April 2013, ARSESP passed Resolution No. 413, which effectively suspended Resolution No. 407, thereby postponing the authorization for the passing on of a municipal tax to consumers' bills, which, prior to this Resolution, had been established in Resolution No. 407. The final decision regarding Resolution No. 407 has been postponed until August 2013.

In August 2012, ARSESP published Resolution No. 346, which established the principle that users should be compensated for any interruptions in water supply. Implementation of this regulation has been suspended pending further technical discussions.

In 2011, ARSESP altered the standard contract that we are required to use in our relationships with retail customers, requiring that invoices be sent to the consumer of the service rather than the owner of the property. We estimate that this change will affect ongoing legal disputes, particularly those regarding collection procedures, as well as business discussions in general. Since this change is still being implemented, we are not currently able to predict its impact on our business.

In 2009 ARSESP enacted rules regarding the following:

- general terms and conditions for water and sewage services;

- procedures for communication regarding any failure in our services;

- penalties for deficiencies in the provision of basic sanitation services; and

- procedures for confidential treatment of our customers' private information.

We are currently evaluating the enforceability and legality of some of these rules. Implementation of these rules started during 2011, is currently ongoing, and is expected to continue for the next few years. The implementation of the above mentioned rules will impact our commercial and operations processes, and may adversely affect us in ways we cannot currently predict.

The Basic Sanitation Law also allows municipalities to create their own regulatory agencies rather than being subjected to overview by ARSESP, and a number of municipalities have therefore created their own regulatory agencies. For example:

- The municipality of Lins, which had decided in 2007 to create its own regulatory authority, revisited this decision in 2010 and transferred the regulation of water activities in Lins, including the setting of tariffs, to ARSESP. Lins has retained, however, the power to ultimately approve the tariff set by ARSESP.

- The municipalities in which the hydrographic basins of the Piracicaba, Capivari and Jundiaí rivers are located created a consortium for the regulation and supervision of our activities in that area in 2011. We are currently involved in legal proceedings in which this consortium is claiming that it has jurisdiction over our activities in the municipality of Piracaia and that ARSESP has no right to regulate our activities or set tariffs in the municipality. We cannot predict the outcome of this case or how it may impact our business.

If other municipalities create new agencies or retain regulatory powers, we will be subject to regulation and supervision by them and to any limitations on our services that they may set. We cannot foresee any changes that any such new agency may implement regarding our business. If any such changes are unfavorable, they could materially and adversely affect us.

For more information on ARSESP regulations, see "Information on the Company—Business Overview—Government Regulation ——"Tariff Regulation in the State of São Paulo" and "Consumer Relations in the State of São Paulo."

New joint entities will be set up to oversee basic sanitation services in metropolitan regions, including the São Paulo Metropolitan Region. We cannot predict how the shared management of these operations will be carried out in the São Paulo Metropolitan Region and other metropolitan regions we operate or what effect this may have on our business, financial condition or results of operations.

There are some pending cases before the Brazilian Supreme Court regarding whether the right to execute concession and program agreements in metropolitan regions belongs to the State or the municipal government. On February 28, 2013 the Brazilian Supreme Court decided a pending case on this matter related to the State of Rio de Janeiro. A majority of the court held that the State of Rio de Janeiro and municipal governments must set up new joint entities to oversee the planning, regulation and auditing of basic sanitation services in metropolitan regions. On March 6, 2013, the court ruled that this decision would come into effect after a 24-month period over the State of Rio de Janeiro. Such decision may be considered a relevant precedent on this matter and therefore similar decisions may be taken on other pending cases as well as on new cases that can be initiated. The São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis), one of which new decisions on such pending or new cases may apply, accounted for 74.1% of our gross revenue from services in 2012 (excluding revenues relating to the construction of concession infrastructure). We cannot predict how the shared management of these operations could be carried out in the São Paulo Metropolitan Region and other municipalities we operate or what effect it may have on our business, financial condition or results of operation.

The terms of our agreement to provide water and sewage services in the City of São Paulo could have a material adverse effect on us.

The provision of water and sewage services in the City of São Paulo accounted for 54.7% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) in the year ended December 31, 2012.

On June 23, 2010, the State and the City of São Paulo executed an agreement in the form of a *convênio*, to which we and ARSESP consented, under which they agreed to manage the planning and investment for the basic sanitation system of the City of São Paulo on a joint basis. The principal terms of this *convênio* were as follows:

- The State and the City of São Paulo would execute a separate agreement with us, granting us exclusive rights to provide water and sewage services in the City of São Paulo.

- ARSESP would regulate and oversee our activities regarding water and sewage services in the City of São Paulo, including tariffs.

- A management committee (*Comitê Gestor*) would be responsible for planning water and sewage services for the City and for reviewing our investment plans. The management committee consists of six members appointed for two-year terms. The State and the City of São Paulo have the right to appoint three members each. We may participate in management committee meetings but may not vote.

In application of the *convênio*, we executed a separate contract with the State and the City of São Paulo, also dated June 23, 2010, to regulate the provision of these services for the following 30 years. The principal terms of this contract are as follows:

- The total investment stated in the contract must be equal to 13% of gross revenues from the provision of services to the City of São Paulo, net of the taxes on revenues, which total approximately R$500 million per year.

- We must transfer 7.5% of the gross revenues we derive under the *convênio*, and subtract (i) COFINS and PASEP taxes, and (ii) unpaid bills of publicly owned properties in the city of São Paulo, to the Municipal Fund for Environmental Sanitation and Infrastructure (*Fundo Municipal de Saneamento Ambiental e Infraestrutura*), established by Municipal Law No. 14,934/2009.

- Our investment plan must be compatible with the sanitation plans of the State, the City of São Paulo and, if necessary, the Metropolitan region.

- ARSESP will ensure that the tariffs will adequately compensate us for the services we provide and that tariffs may be adjusted in order to restore the original balance between each party's obligations and economic gain (*equilíbrio econômico-financeiro*).

We currently have an investment plan in place that reflects these obligations and addresses their compatibility with the sanitation plans for 363 in which we operate, that includes the City of São Paulo and the Metropolitan region. The investment plan is not irrevocable and will be reviewed by our management committee every four years, particularly with respect to the investments to be executed in the subsequent period.

Because we were not previously required to invest 13% of our gross revenues or transfer 7.5% of our gross revenues to the São Paulo Municipal Sanitation and Infrastructure Fund as described above, our existing tariff and adjustment formula do not account for these requirements. Although ARSESP is required to ensure that the tariffs will adequately compensate us for the services we provide, and ARSESP has published Resolution No. 407 authorizing us to pass on specified charges to the municipalities and include these charges in our tariff revisions, Resolution No. 407 has not yet been implemented and the final decision concerning this has been postponed until August 2013. If we cannot pass on these charges to our customers, our financial condition and results of operations could be materially adversely affected. For further information see "Risk Factors – Risks Relating to Our Business – The Brazilian Basic Sanitation Law is still in the process of implementation and interpretation, and doubts remain as to its full impact on the industry. ARSESP, the regulator, has the function to implement regulations under the Basic Sanitation Law within the State of São Paulo, and is in the process of reviewing, implementing and proposing changes to São Paulo State water and sewage regulations, including potentially significant changes to the tariff methodology and structure applicable to our business. The current regulatory uncertainty, and any of the changes that are currently proposed, may have an adverse effect on our business."

We currently lack formal agreements or concessions with 67 of the municipalities to which we provide service, and 38 of our existing concession agreements will expire between 2013 and 2034. We may face difficulties in continuing to provide water and sewage services in return for payment in these and other municipalities, and we cannot assure you that they will continue to purchase services from us on the same terms or at all.

As of December 31, 2012, we provided service to 363 municipalities, of which we held formal 30-year agreements with 258 municipalities (including the City of São Paulo). We executed 33 of these agreements during 2012. The 258 municipalities with which we had formal agreements at year-end accounted for 69.9 % of our total revenues for the year ended December 31, 2012 and 63.5% of our intangible assets as of December 31, 2012. Of the 67 served municipalities for which we lacked formal agreements at year-end, we were in the process of actively renegotiating with all municipalities, including the municipality of Santos. Together, these 67 municipalities accounted for 18.6% of our total revenues for the year ended December 31, 2012 and 26.7% of our intangible assets as of that same date. Between 2013 and 2034, 38 of our existing concession agreements will expire. These 38 concession agreements accounted for 9.4% of our total revenues for the year ended December 31, 2012 and 8.1% of our intangible assets as of that same date.

We may not be able to continue providing service on current terms, or at all, in the municipalities for which we do not have formal agreements, including the 67 for which we are renegotiating expired agreements. In particular, the lack of formal concessions or contractual rights in these municipalities means that we may not be able to enforce our right to continue to provide services and we may face difficulties in being paid on a timely basis, or at all, for the services that we provide. If we are successful in renegotiating the expired agreements, or executing formal agreements with the municipalities for which we have never had agreements, those agreements may not contain terms that are as favorable as those under which we currently operate. We cannot make any such assumption because the Basic Sanitation Law prevents us from planning, regulating and monitoring our services and it requires more stringent control by the municipalities or by ARSESP. The municipalities for which we do not have formal agreements may choose to start providing water and sewage services directly themselves, or may run public tenders to select another provider. They may set eligibility requirements for which we do not qualify and, if we do qualify and participate in these tenders, we may not win. In addition, our ability to continue operating without formal agreements may be modified or cancelled by federal, state or municipal governments, court decisions or other factors.

Any of these events could have a material adverse effect on our business, results of operations and financial condition. See "Item 4.B. Business Overview—Our Operations" and "Item 4.B. Business Overview—Government Regulation—Concessions—Public Consortia and Cooperation Agreement Law for Joint Management."

In the municipalities with which we did not have formal agreements by December 31, 2012, we continued operating with municipal approval or with judicial support.

The municipalities may terminate our concessions before they expire in certain circumstances. The indemnification payments we receive in such cases may be less than the value of the investments we made.

The municipalities have the right to terminate our concessions if we fail to comply with our contractual or legal obligations, or if the municipality determines in expropriation proceedings that early termination of the concession is in the public interest. If a municipality terminates our concession, we are entitled to be indemnified for the unamortized portion of our investments.

The Basic Sanitation Law provides that on early termination of a concession, the entity that provides sanitation services should carry out a valuation of the assets that relate to the services we provide, in order to calculate the unamortized portion of our investments. This valuation uses the criteria defined in the service contract or, in the absence of a contract, is based on customary practice with respect to the services for the preceding 20 years. The resulting indemnification payment may be less than the remaining value of the investments we made.

In addition, the São Paulo State constitution permits the municipalities to pay us this compensation in installments over 25 years. Receiving compensation over this extended period after termination of a significant concession would have a material adverse effect on our financial condition. The Brazilian Supreme Court suspended this deferred payment mechanism in a 1997 decision, but we cannot assure you that the mechanism will not be reinstated. This case is still awaiting a final decision, but on March 15, 2004 the Attorney General issued an opinion that this payment method is unconstitutional. The Basic Sanitation Law reduced the maximum time period for payment of indemnification in such cases to four years. This provision applies to concession agreements entered into prior to the enactment of the Basic Sanitation Law only to the extent that the concession agreement does not contain a contractual indemnification provision, or we have not otherwise entered into an agreement with the municipality with regard to such early termination. These provisions have not yet been tested by the courts and we are therefore unable to predict the effect of the Basic Sanitation Law on our rights to indemnification for the early termination of any particular concession.

In 1997, the municipality of Santos enacted a law in order to repossess our water and sewage systems in Santos. We have adopted the necessary judicial measures to contest this and continue to operate our services in Santos as of December 31, 2012.

In 1995, the municipality of Diadema terminated its concession agreement with us. We commenced legal proceedings against the municipality, which were settled in 1996, but the municipality did not comply with the terms of the settlement. In December 2008, we entered into a memorandum of understanding with the State of São Paulo, the municipality of Diadema and the State Secretariat for Sanitation and Water Resources, previously known as the State Secretariat for Sanitation and Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*). Under this memorandum of understanding the parties agreed to conclude negotiations and settle all outstanding amounts, and we agreed to stay the collection proceedings we had filed against the municipality. In 2011 we and the municipality of Diadema agreed to develop shared infrastructure for water and sewage services through a mixed capital company to be called Companhia de Agua e Esgoto de Diadema, or CAED. According to the agreement, the amount owed to us by Diadema would be repaid through the issuance of shares in CAED. However, CAED has not yet been established, and we cannot predict whether or when it will be created or begin operations. Feasibility studies have been completed and indicate that CAED would have a viable business, but the Diadema municipal authorities have started new negotiations to amend the legislation that provided for the setting up of CAED. We can give no assurance that we will recover the amount owed to us by Diadema, whether through an investment in CAED or otherwise.

For further information on these proceedings, see “Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings.”

Other municipalities may seek to terminate their concession agreements before the contractual expiration date. If this occurs and we do not receive adequate indemnification for our investments, or the indemnification is paid over an extended period, we may suffer material harm to our financial position.

We may face difficulties in collecting overdue amounts owed to us by municipalities to which we provide water on a wholesale basis and municipal government entities.

As of December 31, 2012, our total accounts receivable was R$4,098.0 million. Of this amount, certain municipalities to which we provide water on a wholesale basis owed us R$1,677.7 million, and certain municipal government entities owed us R$792.1 million. Of the total amount owed by municipalities, R$174.3 million was overdue by between 30 and 360 days and R$1,453.3 million was overdue by over 360 days.

The Brazilian courts are entitled to obligate us to continue to supply water to these municipalities, even when we have not received payments due to us. We have no way of ensuring that negotiations with these municipalities or legal action taken against the municipalities will result in payments being made. Some entities associated with municipal governments for which we provide services also do not make regular payments. We cannot guarantee if or when these entities will make payments on a regular basis or pay the amounts owed to us. If the municipalities and related entities do not pay the amounts owed to us, we may suffer material harm to our financial position.

Any failure to obtain new financing may adversely affect our ability to continue our capital expenditure program.

Our capital expenditure program will require resources of approximately R$9.9 billion in the period from 2013 through 2016. In 2012 we recorded R$2.5 billion in capital expenditures.

We have funded these capital expenditures with cash generated by our operations as well as borrowings in Brazilian *reais* and foreign currencies, and we intend to continue to fund our capital expenditures from these sources. A significant portion of our financing needs has been provided by the Brazilian federal public government banks. We have obtained long-term financing at attractive interest rates from multilateral agencies and domestic and international governmental development banks. If the Brazilian government changes its policies regarding the financing of water and sewage services, or if we fail to obtain long-term financing at attractive interest rates from domestic and international multilateral agencies and development banks in the future, we may not be able to meet our obligations or finance our capital expenditure program, which could have a material adverse effect on our business and financial condition.

Governmental agencies, institutional lenders and multilateral agencies constitute our main sources of financing in addition to cash generated by our operations and issuances of debt securities in the domestic and international capital markets. Brazilian financial institutions are legally limited up to a certain percentage of their shareholder’s equity to provide loans to public sector entities, such as us. These limitations could adversely affect our ability to continue our capital expenditure program.

Our debt includes financial covenants that impose indebtedness limits on us, which could have a material adverse effect on us. For further information on these covenants, see “Item 5.B. Liquidity and Capital Resources—Capital Sources—Indebtedness Financing—Financial Covenants.” Our failure to comply with these covenants could seriously impair our ability to finance our capital expenditure program, which could have a material adverse effect on us.

Compliance with environmental laws and environmental liability payments could have a material adverse effect on us.

We are subject to extensive Brazilian federal, state and municipal laws and regulations relating to the protection of human health and the environment. These laws and regulations set water potability standards and limit or prohibit the discharge or spillage of effluent produced in our operations, particularly raw sewage. We occasionally suffer accidents such as leakages or breaks in pipes that could lead to liability for damages under environmental law. We could be subject to various types of criminal, administrative and civil proceedings for non-compliance with environmental laws and regulations, which could expose us to penalties and criminal sanctions, such as fines, closure orders and significant indemnification obligations. The scope and enforcement of environmental laws in Brazil are becoming more stringent, and our capital expenditures and environmental compliance costs may increase substantially as a result. These expenses may lead us to reduce expenditure on strategic investments, which could harm our business. In addition, Brazilian courts are enforcing environmental laws more stringently than in the past, which may result in fines or liability for damages that are significantly higher than those we currently anticipate. We are party to various environmental proceedings that could have a material adverse impact on us, including civil processes and investigations relating to the release of untreated sewage into waterways and the disposal of sludge generated by treatment plants. Any unfavorable judgment in relation to these proceedings, or any material unforeseen environmental liabilities, may have a material adverse effect on us. For further information on these proceedings, see "Item 8.A. Financial Information-Consolidated Statements and Other Financial Information-Legal Proceedings." For further information on investments in environmental programs, see "Item 4.A - Main Projects of our Capital Expenditure Program," "Item 4.B – Busniess Overview – Sewage Treatment and Disposal ," "Item 4.B – Business Overview - Environmental Matters" and "Item 4.B – Business Overview - Environmental Regulation."

New laws and regulations relating to climate change and changes in existing regulation, as well as the physical effects of climate change, may result in increased liabilities and increased capital expenditures, which could have a material adverse effect on us.

Current federal, state and municipal laws and regulations on climate change establish global goals, which we intend to meet concerning greenhouse gas emissions and this may require us to increase our investments in order to comply with these laws. Currently, however, if we increase our capital expenditures for this purpose, we may be required to reduce expenditures on other strategic investments.

In addition, climate change may lead to increases in extreme weather events such as droughts or torrential rain, which may affect our ability to deliver our services and require us to take action such as:

- investing in seeking new water sources located further from major consumer centers;
- investing in new technologies;
- adopting water conservation practices and implementing alternative demand management systems such as economic mechanisms or educational programs; and
- increasing our reserve capacity.

We have not attempted to evaluate the investments that may be necessary as a result of climate change. It may require us to increase expenditures, whether for compliance with changes in environmental regulations or for preventing or remedying the physical effects of climate change. We may be required to adopt new standards aimed at improving energy efficiency and minimizing emissions of greenhouse gases when we renew our operating systems licenses or seek to obtain licenses for new ventures. See "Item 4.B. Business Overview—Environmental Matters—Climate Change Regulations: Reduction of Greenhouse Gases (GHG)."

An increase in sea levels could cause additional intrusion of salt water in the river estuaries where we collect water for treatment, which could generate problems in our treatment, water supply and sanitation systems in coastal areas, including physical damage to facilities and networks. Additionally, increases in air temperature could affect demand for water. Climate change may also reduce water levels in the reservoirs that power hydroelectric plants in Brazil, which may cause energy shortages and increase electricity prices, which may adversely affect our costs and operations.

We cannot predict all of the effects of climate change. We have not provisioned any funds for climate change events as current technology and contrasting scientific understandings of climate change make it difficult to predict potential expenses and liabilities. We may need to make substantial new expenditures, either to comply with new environmental regulations linked to climate change or to prevent or correct the physical effects of climate change, any of which could have a material adverse effect on our results of operations.

We are exposed to risks associated with the provision of water and sewage services.

Our industry is affected by the following additional risks relating to the provision of water and sewage services:

- The state and federal government agencies that manage water resources impose substantial charges for the abstraction of water from bodies of water and the discharge of sewage. We may not be able to pass these charges on to our customers. See "Item 4.B. Business Overview—Government Regulation—Water Usage."

- The degradation of watershed areas may affect the quantity and quality of water available to meet demand from our customers. See "Item 4.A. History and Development of the Company—Capital Expenditure Program" and "—Main Projects of Our Capital Expenditure Program."

- In addition to the risks discussed under "—The terms of our new agreement to provide water and sewage services in the City of São Paulo could have a material adverse effect on us," we may not be able to increase our tariffs on a timely basis, or at all, in order to pass on increases in inflation or operating expenses, including taxes, to our customers. These constraints may have an adverse effect on our ability to fund our capital expenditure program and financing activities, and to meet our debt service requirements. See "Item 5.A. Operating and Financial Review and Prospects—Factors Affecting Our Results of Operations—Effects of Tariff Increases."

- In addition to the risks discussed under "— New laws and regulations relating to climate change and changes in existing regulation, as well as the physical effects of climate change, may result in increased liabilities and increased capital expenditures, which could have a material adverse effect on us," we are exposed to various weather-related risks, since our financial performance is closely linked to climate patterns. The expected increase in the frequency of extreme weather conditions in the future may adversely affect both the quality and quantity of waters available for abstraction, treatment, and supply. Droughts could adversely affect the water supply systems, resulting in a decrease in the volume of water distributed and billed as well as in the revenue derived from water supply services. An increase in heavy rainfall could impact water quality and the regular operation of water sources, including abstraction of waters from our dams, due to increased soil erosion, silting, pollution and eutrophication of aquatic ecosystems. See "Item 5.A. Operating and Financial Review and Prospects—Factors Affecting Our Results of Operations—Effects of Climate Change (Drought and Intense Rainfalls)."

- We are dependent upon energy supplies to conduct our business. Any shortages or rationing of energy may prevent us from providing water and sewage services, and may also cause material damage to our water and sewage systems when we resume operations. Also, we may not be able to pass on any significant increases in energy tariffs to our customers. See "Item 4.A. History and Development of the Company-Energy Consumption."

Any of the above may have a material adverse effect on us.

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

We are party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, civil, environmental, tax, labor, criminal and other proceedings. As of December 31, 2012, the total value of all outstanding claims against us was R$36,866.9 million (net of R$330.2 million in court deposits). A substantial monetary judgment against us in one or more of these legal proceedings may have a material adverse effect on our financial condition. We have provisioned a total aggregate amount of R$1,189.2 million (net of court deposits) as of December 31, 2012 to cover probable losses related to legal proceedings. This provision does not cover all legal proceedings involving monetary claims filed against us and it may be insufficient to cover our liabilities related to these claims. Any unfavorable judgment in relation to these proceedings may have a material adverse effect on us. For more information, see "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings."

Risks Relating to Our Common Shares and ADSs

We may not always be in a position to pay dividends or interest on shareholders' equity and ADSs.

Depending on our future results, our shareholders may not receive dividends or interest on own capital if we do not generate a profit. Despite the requirement to distribute a minimum of 25% of our annual net income to shareholders, our future financial position may not permit us to distribute dividends or pay interest on own capital.

The relative volatility and illiquidity of the Brazilian securities markets may substantially limit your ability to sell our common shares underlying the ADSs at the price and time you desire.

Investing in securities from emerging markets such as Brazil involves greater risk than investing in securities of issuers in major securities markets, and these investments are often considered to be more speculative in nature. The Brazilian securities market is substantially smaller, less liquid, more concentrated and can be more volatile than major securities markets. Accordingly, although you are entitled to withdraw the common shares underlying the ADSs from the depositary at any time, your ability to sell the common shares underlying the ADSs at a price and time at which you wish to do so may be substantially limited. There is also significantly greater concentration in the Brazilian securities market than in major securities markets. The ten largest companies in terms of market capitalization represented approximately 51.8% of the aggregate market capitalization of the BM&FBOVESPA as of December 31, 2012. The top ten stocks in terms of trading volume accounted for approximately 43.0%, 47.2% and 48.8% of all shares traded on the BM&FBOVESPA in 2012, 2011 and 2010, respectively.

Investors who exchange ADSs for common shares may lose their ability to remit foreign currency abroad and obtain Brazilian tax advantages.

The Brazilian custodian for the common shares underlying our ADSs must obtain a certificate of registration from the Central Bank in order to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to our common shares or upon sales of our common shares. If an ADR holder decides to exchange ADSs for the underlying common shares, the holder will be entitled to continue to rely on the custodian's certificate of registration for five business days from the date of exchange. After that period, the holder may not be able to obtain and remit U.S. dollars abroad upon sale of our common shares, or distributions relating to our common shares, unless he or she obtains his or her own certificate of registration or registers under Resolution No. 2,689, dated January 26, 2000, of the CMN, which entitles registered foreign investors to buy and sell on a Brazilian stock exchange. If the holder does not obtain a certificate of registration or register under Resolution No. 2,689, the holder 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, the holder 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. The custodian's certificate of registration or any foreign capital registration obtained by a holder may be affected by future legislative changes, and additional restrictions applicable to the holder, the disposition of the underlying common shares or the repatriation of the proceeds of disposition may be imposed in the future.

A holder of common shares or ADSs may face difficulties in protecting his or her interests as a shareholder because we are a Brazilian mixed capital 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 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 more difficulty 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, since the State may only be able to pay a judgment if it is provided for in its budget in a subsequent fiscal year. None of the public property of our controlling shareholder is available for seizure or attachment, either prior to or after judgment.

Mandatory arbitration provisions in our bylaws may limit the ability of a holder of our ADSs to enforce liability under U.S. securities laws.

Under our bylaws, any disputes among us, our shareholders and our management with respect to the *Novo Mercado* rules, Brazilian Corporate Law and Brazilian capital markets regulations will be resolved by arbitration conducted pursuant to the BM&FBOVESPA Arbitration Rules in the Market Arbitration Chamber. Any disputes among shareholders, including ADR holders, and any disputes between us and our shareholders, including ADR holders, will also be submitted to arbitration. As a result, a court in the United States might require that a claim brought by an ADR holder predicated upon the U.S. securities laws be submitted to arbitration in accordance with our bylaws. In that event, a purchaser of ADSs would be effectively precluded from pursuing remedies under the U.S. securities laws in the U.S. courts.

A holder of our common shares and ADSs might be unable to exercise preemptive rights and tag-along rights with respect to the common shares.

U.S. holders of common shares and ADSs may not be able to exercise the preemptive rights and tag-along rights relating to common shares unless a registration statement under the U.S. Securities Act of 1933, as amended, or the Securities Act, 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 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, an ADR holder may receive only the net proceeds from the sale of his or her preemptive rights and tag-along rights or, if these rights cannot be sold, they will lapse and the ADR holder will receive no value for them.

A holder of our ADSs may find it more difficult than a holder of our common shares 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 ADRs only in accordance with the deposit agreement relating to our ADRs. Neither Brazilian law nor our bylaws limit the ability of ADR holders to exercise their voting rights with respect to the underlying common shares through the depositary. However, the additional procedural steps involved in communicating with ADR holders impose practical limitations on the exercise of voting rights. 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. ADR 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 in turn will mail the notice of the meeting to ADR holders as soon as practicable after publication, along with a statement as to the manner in which holders may give voting instructions, but only if we request the depositary to do so. To exercise their voting rights, ADR holders must then give instructions to the depositary. Due to these procedural steps, the process for exercising voting rights may take longer for ADR holders than for holders of common shares. The deposit agreement provides that if the depositary does not receive any instructions from a holder of ADRs, the ADR holder may be deemed to have given a discretionary proxy to a person designated by our company and the underlying shares may be voted by such person. However, we chose not to designate any person to exercise these deemed proxy rights with respect to the annual general meeting held to approve our financial statements for 2012, and ADSs for which no specific voting instructions were received by the Depositary were therefore not voted at that meeting.