COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP
Form 20-F/A
September 21, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F/A

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2011**

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

OR

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Date of event requiring this shell company report_____

Commission file number 001 31317

Companhia de Saneamento Básico do Estado de São Paulo - SABESP
(Exact name of Registrant as specified in its charter)

Basic Sanitation Company of the State of São Paulo SABESP
(Translation of the Registrant's name into English)

Federative Republic of Brazil
(Jurisdiction of incorporation or organization)

Rua Costa Carvalho, 300
05429 900 São Paulo, SP, Brazil
(Address of principal executive offices)

Rui de Britto Álvares Affonso

raffonso@sabesp.com.br

(+55 11 3388 8247)

Rua Costa Carvalho, 300 05429-900 São Paulo, SP, Brazil

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Shares, without par value	New York Stock Exchange*
American Depositary Shares, evidenced by American Depositary Receipts, each representing 2 Common Shares[(1)]	New York Stock Exchange

_____

* Not for trading purposes, but only in connection with the registration of American Depositary Shares pursuant to the requirements of the Securities and Exchange Commission.
(1) Until June 8, 2007, each American Depositary Share, evidenced by American Depositary Receipts, represented 250 Common Shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

227,836,623 Shares of Common Stock

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes þ No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes o No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP o International Financial Reporting Standards as issued by the International Accounting Standards Board þ Other o

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow

Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

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PRESENTATION OF FINANCIAL AND OTHER INFORMATION

General

We maintain our books and records in *reais*. We prepared our consolidated financial statements as of and for the years ended December 31, 2009, 2010 and 2011 included in this annual report in compliance with International Financial Reporting Standards, or IFRS, as issued by the International Accounting Standards Board, or IASB.

Convenience Translations

We have translated some of the *real* amounts contained in this annual report into U.S. dollars. The rate used to translate such amounts in respect of the year ended December 31, 2011 was R$1.876 to US$1.00, which was the commercial rate for the purchase of U.S. dollars in effect on December 31, 2011, as reported by the Central Bank. The U.S. dollar equivalent information presented in this annual report is provided solely for the convenience of reader and should not be construed as implying that the *real* amounts represent, or could have been or could be converted into, U.S. dollars at the above rate. See "Item 3.A. Selected Financial Data—Exchange Rates" for more detailed information regarding the Brazilian foreign exchange system and historical data on the exchange rate of the *real* against the U.S. dollar.

Rounding

Some percentages and numbers included in this annual report have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

Other Information

In this annual report, unless the context otherwise requires, references to "we," "us," "our," "Company," or "SABESP" refer to Companhia de Saneamento Básico do Estado de São Paulo - SABESP.

In addition, references to:

§ "*real,*" "*reais*" or "R$" are to the Brazilian *real*, the official currency of Brazil;

§ "U.S. dollars" or "US$" are to the United States dollar, the official currency of the United States;

§ "Brazil" are to the Federative Republic of Brazil;

§ "State" are to the State of São Paulo, which is also our controlling shareholder;

§ "federal government" and "Brazilian government" are to the federal government of the Federative Republic of Brazil and "state government" are to the state government of the State of São Paulo;

§ "São Paulo metropolitan region" are to the area where the Metropolitan executive office operates, comprising 38 municipalities, including the city of São Paulo;

§ “Regional systems” are to the area where the Regional systems executive office operates, comprising 325 municipalities in the interior and coastline regions of the State of São Paulo;

§ “water coverage ratio” are to the ratio between the number of residences connected to the water supply network, divided by the number of urban residences in a certain area; and

§ “sewage coverage ratio” are to the ratio between the number of residences connected to the sewage collection network, divided by the number of urban residences in a certain area.

Information in this annual report related to liters, water and sewage volumes, number of employees, kilometers, water and sewage connections, population served, operating productivity, water production rate, sewage lines (in kilometers), savings achieved and investment in improvement programs has not been audited.

Market Information

We make statements in this annual report about our market share and other information relating to Brazil and the industry in which we operate. We have made these statements on the basis of information from third-party sources and publicly available information that we believe is reliable, such as information and reports from the Brazilian Institute of Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*), or IBGE, and the State Data Analysis System Foundation (*Fundação Sistema Estadual de Análise de Dados*) or SEADE, among others. We have no reason to believe any of this information is inaccurate in any material respect.

References to urban and total population in this annual report are estimated based on a research made by the SEADE: "Projections for the State of São Paulo – Population and Residences until 2025" (*Projeções para o Estado de São Paulo – População e Domicílios até 2025*).

CAUTIONARY STATEMENTS ABOUT FORWARD LOOKING STATEMENTS

This annual report includes forward-looking statements, mainly in Items 3 through 5. We have based these forward looking statements largely on our current expectations and projections about future events and financial trends affecting our business. These forward-looking statements are subject to risks, uncertainties and assumptions, including, among other factors:

§ general economic, political, demographical and other conditions in Brazil and in other emerging market countries;

§ changes in applicable laws and regulations, as well as the enactment of new laws and regulations, including those relating to environmental, tax and employment matters in Brazil;

§ fluctuations in inflation, interest rates and exchange rates in Brazil;

§ the interests of our controlling shareholder;

§ our ability to collect amounts owed to us by our controlling shareholder and by municipalities;

§ our ability to continue to use certain reservoirs under current terms and conditions;

§ our capital expenditure program and other liquidity and capital resources requirements;

§ droughts, water shortages, intensive rains and other climate events;

§ power shortages or rationing in energy supply or significant changes in energy tariffs;

§ the effects of the agreement for provision of water and sewage services in the city of São Paulo, that we executed with the State and the city of São Paulo;

§ our lack of formal agreements with certain municipalities to which we render our water and sewage services, including the cities comprising metropolitan regions;

§ the municipalities' ability to terminate our existing concession agreements prior to their expiration date and our ability to renew such agreements;

§ our ability to provide water and sewage services in additional municipalities and to maintain our rights to provide the services currently contracted;

§ the size and growth of our customer base;

§ our ability to comply with certain levels of services and attendance in the provision of water and sewage services established in our agreements with the municipalities;

§ our level of indebtedness and limitations on our ability to incur additional indebtedness;

§ our ability to access financing with favorable terms in the future;

§ our costs relating to compliance with environmental laws and potential penalties for failure to comply with these laws;

§ our exposure to probable increases in the frequency of extreme weather conditions;

§ the outcome of our pending or future legal proceedings;

§ our management's expectations and estimates relating to our future financial performance;

§ the regulation issued by the São Paulo State Sanitation and Energy Regulatory Agency, or the ARSESP, regarding several aspects of our business, including limitations on our ability to set and adjust our tariffs; and

§ other risk factors as set forth under "Item 3.D. Risk Factors."

The words "believe," "may," "estimate," "continue," "anticipate," "plan," "intend," "expect" and similar words are intended to forward-looking statements. In light of these risks and uncertainties, the forward looking events and circumstances discussed in this annual report might not occur. Our actual results could differ substantially from those anticipated in our forward-looking statements. Forward looking statements speak only as of the date they were made and we do not undertake the obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law. Any such forward looking statements are not an indication of future performance and involve risks.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The tables below contain a summary of our financial data as of and for each of the periods indicated. The summary of our financial data was derived from our consolidated annual financial statements, prepared in compliance with IFRS, as issued by the IASB. You should read this selected financial data in conjunction with our consolidated financial statements and the related notes thereto included in this annual report.

The selected consolidated financial information as of and for the years ended December 31, 2009, 2010 and 2011 prepared in compliance with IFRS, has been derived from our audited consolidated financial statements, which appear elsewhere in this annual report.

The following tables present our selected financial data as of and for each of the periods indicated.

IFRS Summary Financial Data	**Year ended December 31,**		
	2009	**2010**	**2011**
	(in millions of reais*, except per share and per ADS(1) data)*		
Statement of operations data:			
Net revenue from sales and services	8,579.5	9,231.0	9,941.6
Cost of sales and services	(5,087.3)	(5,194.5)	(6,031.1)
Gross profit	3,492.2	4,036.5	3,910.5
Selling expenses	(610.4)	(712.9)	(619.5)
Administrative expenses	(717.1)	(653.2)	(846.6)
Operating profit	2,120.3	2,672.2	2,354.3
Financial income (expenses), net	(10.0)	(379.4)	(633.6)
Net income	1,507.7	1,630.5	1,223.4
Earnings per share – basic and diluted	6.62	7.16	5.37
Earnings per ADS – basic and diluted	13.24	14.32	10.74

Dividends and interest on shareholders' equity per share	1.73	2.00	1.27
Weighted average number of common shares outstanding	227,836,623	227,836,623	227,836,623

(1) American Depositary Shares, or ADS.

	As of December 31,		
	2009	**2010**	**2011**
	(in millions of reais*)*		
Balance sheet data:			
Property, plant and equipment, net (*)	190.4	249.6	356.5
Intangible assets, net (*)	16,917.5	18,546.8	20,141.7
Total assets	20,243.1	23,350.6	25,215.0
Short-term loans and financing	1,009.9	1,242.1	1,630.0
Long-term loans and financing	5,548.0	7,022.5	6,966.3
Interest on shareholders' equity payable	365.4	354.3	247.5
Total liabilities	11,804.5	13,668.8	14,669.1
Shareholders' equity	8.438.6	9,681.8	10,545.9
Capital stock	6,203.7	6,203.7	6,203.7
Other financial information:			
Cash provided by operating activities	2,072.5	2,083.0	2,717.1
Cash used in investing activities	(1,964.0)	(2,091.4)	(2,008.3)
Cash provided by (used in) financing activities	36.9	1,226.5	(548.0)
Capital expenditures	(1,982.4)	(1,901.5)	2,211.1

(*) Reclassification between property, plan and equipment and intangible assets, in the amounts of R$139.8 million in 2009.

Operating Data

	As of and for the year ended December 31,				
	2007	**2008**	**2009**	**2010**	**2011**
Number of water connections (in thousands)	6,767	6,945	7,118	7,295	7,481
Number of sewage connections (in thousands)	5,167	5,336	5,520	5,718	5,921
Percentage of population with water connections (in percentages)	99	99	99	99	99
Percentage of population with sewer connections (in percentages)	79	79	80	81	82
Volume of water billed during period (in millions of cubic meters)	1,847	1,878	1,917	1,992	2,045
Water loss percentage during period (average)(in percentages)(1)	29.5	27.9	26.0	26.0	25.6
Water loss per connection (average)(2)	467	436	402	403	395
Number of employees	16,850	16,649	15,103	15,330	14,896

(1) Includes both physical and non physical losses. Water loss percentage represents the quotient of (i) the difference between (a) the total amount of water produced by us less (b) the total amount of water invoiced by us to customers minus (c) the volume of water set out below that we exclude from our calculation of water losses, divided by (ii) the total amount of water produced. We exclude from our calculation of water losses the following: (i) water discharged for periodic maintenance of water mains and water storage tanks; (ii) water supplied for municipal uses such as firefighting; (iii) water we consume in our facilities; and (iv) estimated water losses associated with water we supply to *favelas* (shantytowns).

(2) Measured in liters/connection per day, according to the method of measuring our water losses, based on worldwide market practice for the sector. See "Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Losses."

Exchange Rates

In the past, the Brazilian National Monetary Council (*Conselho Monetário Nacional*), or the CMN, has introduced changes to the Brazilian foreign exchange regime, such as unifying the Commercial and Floating Markets and easing the rules governing Brazilian residents' ability to acquire foreign currency, among others. On March 24, 2010, the CMN and the Central Bank approved Resolution No. 3,844, under which a series of measures were adopted to consolidate and simplify acts and proceedings applicable to foreign exchange market regulations in Brazil.

The Brazilian foreign exchange system allows for the purchase and sale of foreign currency and the international transfer of *reais* by any person or legal entity, regardless of the amount, subject to certain regulatory procedures.

The Brazilian currency has, during the last few decades, experienced frequent and substantial variations in relation to the U.S. dollar and other foreign currencies. Between 2003 and mid-2008, the *real* appreciated significantly against the U.S. dollar with the exchange rate reaching R$1.634 in August 2008. Primarily, as a result of the global financial crisis, the *real* depreciated 32.0% against the U.S. dollar during 2008 and closed the year at R$2.337 per US$1.00, but strengthened during 2009 and 2010. In 2011, the real suffered a deprecitation of 12.6% against the U.S. dollar. On December 31, 2009, 2010 and 2011, the *real*/U.S. dollar exchange rate was R$1.741, R$1.666 and R$1.876 per US$1.00, respectively.

The Central Bank has intervened occasionally to combat instability in foreign exchange rates. We cannot predict whether the Central Bank or the Brazilian government will continue to let the *real* float freely or will intervene in the exchange rate through a currency band system or otherwise. The *real* may fluctuate against the U.S. dollar substantially in the future. For further information on these risks, see "Item 3.D. Risk Factors—Risks Relating to Brazil—Exchange rate instability may adversely affect us and the market price of our common shares or ADSs."

The following tables set forth the selling rate, expressed in *reais* per U.S. dollar (R$/US$), for the periods indicated.

		R$ per US$1.00		
Year ended December 31,	**Year end**	**Average[(1)]**	**High**	**Low**
2007	1.771	1.948	2.156	1.733
2008	2.337	1.837	2.500	1.559
2009	1.741	1.994	2.422	1.702
2010	1.666	1.759	1.881	1.655
2011	1.876	1.675	1.902	1.535

		R$ per US$1.00		
Month ended	**Period end**	**Average[(1)]**	**High**	**Low**
December 31, 2011	1.876	1.837	1.876	1.783
January 31, 2012	1.739	1.790	1.868	1.739
February 29, 2012	1.709	1.718	1.738	1.702
March 31, 2012	1.822	1.795	1.833	1.715
April 27, 2012 (through April 23, 2012)	1.886	1.845	1.889	1.826

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Source: Central Bank

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

On April 23, 2012, the exchange rate published by the Central Bank was R$1.886 per US$1.00. Exchange rate fluctuations will affect the U.S. dollar equivalent of the *real* price of our common shares on the São Paulo Stock Exchange (BM&FBOVESPA S.A. - *Bolsa de Valores, Mercadorias e Futuros*), or the BM&FBOVESPA, as well as the U.S. dollar equivalent of any distributions we make in *reais* with respect to our common shares.

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, increases in interest rates, changes in tax policies, price and tariff controls, currency devaluations, 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.

Uncertainty over whether the Brazilian government will implement changes in policies or regulations affecting these or other factors may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets and in the 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, in the past, experienced extremely high rates of inflation. 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 markets. 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, at the end of 2009, 2010 and 2011 was 8.65%, 10.66% and 10.91% respectively, in line with the target rate set by the Brazilian Committee on Monetary Policy (*Comitê de Política Monetária*), or COPOM.

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, in 2009, there was a deflation of 1.71% and the rate of inflation for 2010 and 2011 were 11.32% and 5.1% 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 again experiences high inflation, 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 decline 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 last decades. Throughout this period, the Brazilian government has implemented various economic plans and utilized a number of 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, there have been 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, as a result of the worsening of the international economic crisis, the *real* depreciated by 32.0% against the U.S. dollar. In 2009 and 2010, the *real* appreciated 25.5% and 4.3% against the U.S. dollar, closing at R$1.741 and R$1.666 per US$1.00, respectively. In 2011, the *real* suffered a depreciation of 12.6% against the U.S. dollar, closing at R$1.876 per US$1.00. There can be no assurance that the *real* will not further depreciate against the U.S. dollar. As of April 23, 2012, the commercial selling rate as reported by the Central Bank was R$ 1.886 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 access to financial markets and prompt government intervention, including recessionary governmental policies. Depreciation of the *real* against the U.S. dollar can also, as in the context of the current global economic recovery, 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, particularly because our tariff revenue and other sources of income are denominated solely in *reais*. In addition, because we have foreign currency denominated indebtedness, any significant devaluation of the *real* 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$3,053.4 million as of December 31, 2011, and we anticipate that we may incur substantial amounts of foreign currency denominated indebtedness in the future. In 2011, our results of operations were negatively affected by the 12.6% depreciation of the *real* against the U.S. dollar, which amounted to R$382.3 million. We do not currently have any hedging 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. Crisis 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 had 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 our or from minority shareholders' interests, which could have a material adverse effect on us.

The State of São Paulo, through its ownership of our common shares, has the ability to determine our operating policies and strategy, to control the election of a majority of the members of our board of directors and to appoint our senior management. As of April 23, 2012, the State owned 50.3% of our outstanding common shares.

The State has directed from time to time in the past, and may direct in the future, through its control of our board of directors and through the enactment of State decrees, that we engage in certain business activities and make certain expenditures that promote political, economic or social goals but that do not necessarily also enhance our business and results of operations. See "Item 5.A. Operating and Financial Review and Prospects—Factors Affecting Our Results of Operations."

Following the 2010 elections for State governor, in 2011 the new governor elected Ms. Dilma Seli Pena as our chief executive officer 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.

We have a substantial amount of accounts receivable owed to us by the State and some State entities, and we cannot assure you as to when or whether the State will pay us.

Historically, the State and some State entities have had substantial overdue accounts payable to us relating to (i) the provision of water and sewage services and (ii) 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, 2011, the amounts owed to us by the State for the provision of water and sewage services totaled R$145.4 million. With respect to payment of pensions on behalf of the State, as of December 31, 2011, we believe that the State owed to us R$1,290.7 million, but due to the uncertainty regarding the recovery of the amount our management decided not to record the reimbursements that we believe are due to us. In addition, as of December 31, 2011, we had recorded a

provision for actuarial liability in the amount of R$1,512.1 million in respect of future supplemental pension payments the State does not believe it is responsible for paying. 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 these overdue amounts payable to us. For a detailed discussion of these agreements, see "Item 7.B. Related Party Transactions," and Note 8 to our consolidated financial statements. Pursuant to these agreements, 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 in the amount of R$133.7 million (as of November 30, 2007), in 60 consecutive monthly installments, beginning on January 2, 2008, and an amount of R$236.1 million relating to part of the accounts overdue and unpaid from March 2004 through October 2007 regarding the provision of water supply and sewage collection services. We agreed to pay the State the outstanding balance of dividends, in the form of interest on shareholders' equity, due from March 2004 through December 2006, in the amount of R$400.8 million, in the period from January through March 2008.

In March 2008, we entered into a commitment agreement with the State for the settlement of outstanding debts related to the reimbursement of pension benefits. Pursuant to the commitment agreement, the amounts due to us with respect to payments of pensions on behalf of the State may be partially settled through the transfer to us of certain reservoirs in the Alto Tietê System that we use and are owned by the State. In November 2008, we entered into an agreement with the State relating to payments of pension benefits made by us on its behalf. The State acknowledged that it owed us the outstanding balance of R$915.3 million as of September 30, 2008 relating to payments of pension benefits made by us on its behalf. 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 of these reservoirs to us. In November 2008, the State began paying the remaining balance in the amount of R$219.0 million in 114 successive monthly installments. We are unable to predict whether and when these reservoirs will be transferred to us because the Public Prosecution Office of the State of São Paulo (*Ministério Público do Estado de São Paulo*) filed a civil public action alleging that a transfer to us of ownership of the Alto Tietê System reservoirs is illegal. The Company and the São Paulo State Government are working together to obtain legislative authorization to transfer the reservoirs to us, overcoming the uncertainties arising from the public lawsuit challenging the absence of a specific legislative authorization for the transfer of the property of the reservoirs.

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 acknowledges it owes us pursuant to the November 2008 agreement, we are negotiating with the State further amounts that the State does not recognize it owes us. While we continue to negotiate directly with the State, we are not able to assure you that we will be successful in these negotiations. Accordingly, as of December 31, 2011, we have not recorded R$1,290.7 million related to reimbursements that we believe are due to us for pension benefits paid on behalf of the State, but we have recorded R$1,512.1 million in pension obligations.

We cannot assure you when or if the State will pay the total overdue amounts owed to us. Due to the State's history of not making timely payments to us in respect of services and of not reimbursing us in a timely manner for the payments of pensions on behalf of the State, 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.

We may be required to acquire reservoirs that we use and that are owned by a State-controlled company, or we may be required to pay substantial charges to the owner with respect to our use of these reservoirs.

In connection with the provision of water services, we use the Billings and Guarapiranga reservoirs which are owned by a State controlled company, the Water and Energy Metropolitan Company (*Empresa Metropolitana de Águas e Energia S.A.*), or the EMAE. We are entitled to use these reservoirs based on a grant issued by the State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*), or DAEE. The State, through its control of our board of directors, could require us to acquire the Billings and Guarapiranga reservoirs. As a result of these acquisitions, our cash position and overall financial condition could be adversely affected. In addition, since we are not currently charged for the use of these reservoirs, we 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 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 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

We cannot anticipate the effects that further developments of the Basic Sanitation Law and its interpretation will have on the basic sanitation industry in Brazil and on us.

Law No. 11,445, or the Basic Sanitation Law, was enacted on January 5, 2007. While it has been in effect for more than five years, it is still in its early stages of implementation in Brazil, and we continue to be unable to anticipate all of the effects that it might have on our operations and business. There are still several uncertainties related to the interpretation of the Basic Sanitation Law. On June 21, 2010, the federal government enacted Federal Decree No. 7,217 regulating the Basic Sanitation Law. Among other things, Law No. 11,445 and Federal Decree No. 7,217 provided that (i) public hearings regarding the bid announcements and technical and economic viability studies are requirements for the validity of public-public partnership contracts (program contracts) ; (ii) the rights and obligations, including penalties, of customers and service providers shall be ruled by the owner of the public service, not by the regulatory agency; (iii) financial feasibility may be demonstrated by means of the requirement for new investments, other than the proceeds arising from the rendering of services; and (iv) when a service is divided and rendered by different service providers, the services will be considered as interdependent and will be subject to an agreement that will regulate the activities of the different services providers. We cannot currently anticipate all the effects that the law and the decree will have on our business and operations, if any.

Pursuant to the Basic Sanitation Law, tariff regulation is to be performed by an independent regulatory entity. To exercise this assignment, the State of São Paulo created the São Paulo State Sanitation and Energy Regulatory Agency, or the ARSESP. The ARSESP is the State agency responsible for regulating the basic sanitation industry, including tariff regulation in certain municipalities. The ARSESP acts as tariff regulator both in municipalities where the State provides basic sanitation services (municipalities in metropolitan areas), and in those municipalities that have delegated their regulatory powers to the State through cooperation agreements. The ARSESP presently regulates our tariff structure and adjustments pursuant to the same tariff structure and adjustment formula that we otherwise apply. Pursuant to a cooperation agreement among the State and some municipalities, the ARSESP also regulates our tariffs in municipalities that have selected the ARSESP to regulate our tariffs.

Since 2008, the ARSESP has been developing new concepts in the tariff structure and adjustment formula. In July 30, 2010, the ARSESP published Resolution No. 156 establishing the methodology and general criteria for the definition of our regulatory asset base, in order to move forward with the tariff review process and to define the initial parameters of the auditing process that the ARSESP will have to conduct pursuant to the terms of the Basic Sanitation Law. Throughout 2011 and 2012, the ARSESP commenced public consultations regarding the methodology for tariff revisions. The ARSESP estimates that a final public hearing at which our preliminary average tariff, efficiency gains factor and tariff structure will be subjected to public scrutiny will be scheduled by November 2012. However, although the ARSESP has indicated that it will implement the new tariff methodology in 2012, we cannot assure you when the new rules will be enacted, and the aforementioned schedule may suffer alterations or be subject to delays. We cannot anticipate the additional changes that the ARSESP will implement on our tariff structure and adjustment formula or the effects that these changes will have on us. If the changes are unfavorable to us, they could materially and adversely affect us.

Furthermore, since Law No. 11,445 permits municipalities to create their own regulatory agencies rather than being subjected to overview by the ARSESP, a number of municipalities created their own regulatory agencies. The municipality of Lins, which had decided in 2007 to create its own regulatory authority, revised this decision in 2010 and transferred the regulation of the water activities performed in Lins, including the setting of tariffs to the ARSESP. Lins has retained, however, the power to ultimately approve the tariff set by the ARSESP. The municipalities in which the hydrographic basins of the rivers Piracicaba, Capivari and Jundiaí are located have created a consortium for regulation and supervision of our activities in that area. As this regulatory entity has recently been created, we cannot predict how it may implement regulation changes that may affect our activities. If other municipalities create new agencies or retain regulatory powers, we will be subject to their regulation, supervision and limitations to our services. We cannot foresee any changes that any such new agency may implement regarding our business, and if the changes are unfavorable, they could materially and adversely affect us.

Pursuant to the Basic Sanitation Law, the ARSESP has enacted, in 2009, certain rules establishing (i) the general conditions for the services we render, (ii) the communication process for any failure in our services; (iii) penalties for deficiencies in the provision of basic sanitation services; and (iv) procedures for confidential treatment of our clients' private information. We are currently evaluating the enforceability and legality of some of these rules. Implementation of these rules started during 2011 and is expected to continue for the next few years. The implementation of these rules will impact our commercial and operations processes and may adversely affect us as described below and in other ways we cannot currently predict.

In particular, regarding changes to the general conditions for our services, in 2011 the ARSESP altered the standard contract that we are required to use in our relationships with retail costumers. The ARSESP changed the rule regarding the collection of water and sewage tariff, requiring that collection be directed to the consumer of our services, rather than to the owner of the served property, as used to be the case. We estimate that this change will affect ongoing legal disputes, particularly those regarding collection procedures, as well as business discussions in

general. However, we are not currently able to predict the impact of this change on our business, as the change is still being implemented.

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

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.

Our provision of water and sewage services in the city of São Paulo accounted for 55.1% of our gross revenues from sales and services (excluding revenues relating to the construction of concession infrastructure) in the year ended December 31, 2011.

On June 23, 2010 the State and the city of São Paulo entered into a convention (*convênio*) with the intermediation and our consent and the consent of the ARSESP pursuant to which they agreed to jointly manage the planning of and investment in the basic sanitation system of the city of São Paulo, among other things. This agreement established that the State and the city of São Paulo would enter into an agreement with us, granting us exclusive rights with respect to the provision of water and sewage services in the city of São Paulo. In addition, the agreement established the role of the ARSESP in regulating and overseeing our activities (including the tariffs we collect) and established a management committee (*Comitê Gestor*) that will be responsible for planning the water and sewage services and for reviewing our investment plans. The management committee will be composed of six members appointed for two year terms. The State and the city of São Paulo will have the right to appoint three members each. We are permitted to participate in the meetings of the management committee; however, we are not afforded any voting rights

Also, on June 23, 2010, we entered into a formal agreement with the State and the city of São Paulo to regulate the provision of these services. This agreement requires, among other things, (i) that the estimated investments mentioned in the agreement comply with 13% of the gross revenue from the municipality of São Paulo, net of the taxes on revenues. The investment plan, upon its execution by us, must be compatible with the activities and programs included in the sanitation plan of the State, Municipality, and if necessary, of the Metropolitan region. The invest plan is not irrevocable and will be reviewed by our management committee every four years, especially the investments to be executed in the subsequent period; and (ii) that we contribute 7.5% of the gross revenues from sales and services we obtain from this agreement, net of COFINS and PASEP taxes, to the Municipal Fund for Environmental Sanitation and Infrastructure (*Fundo Municipal de Saneamento Ambiental e Infraestrutura*), or the São Paulo Municipal Sanitation Fund, established by Municipal Law No. 14,934/2009. In addition, the agreement provides that the ARSESP will ensure that the tariffs charged (a) will adequately compensate us for the services we provide and (b) can be adjusted to restore the original balance between each party's obligation and economic gain (*equilíbrio econômico-financeiro*). We currently have an investment plan in place that reflects these obligations and addresses their compatibility with the activities and programs included in the sanitation plan of the State and of the municipality of São Paulo and, if necessary, the plan of the metropolitan region of São Paulo. This investment plan will be reviewed by a management committee every four years so as to ensure compliance with government policies and contractual terms.

Because we were not previously required to make the mandatory allocations described in items (i) and (ii) above, they were not taken into account in calculating our existing tariff and its adjustment formula. Despite the contractual provisions and the ARSESP's role in setting and adjusting adequate tariffs, which are necessary for our economic and financial balance, we cannot guarantee that the tariffs we will be allowed to charge for the provision of water and sewage services in the city of São Paulo will continue to adequately compensate us.

A decision of the Brazilian Supreme Court regarding whether State or municipal governments have the right to execute concession and program agreements in metropolitan regions could have a material adverse effect on us.

Our provision of water and sewage services in the metropolitan regions in which we operate is governed by agreements with the relevant State authorities (other than in the city of São Paulo, where we now have an agreement with the municipal authorities as well as the State). In a lawsuit initiated by third parties that is currently before the Brazilian Supreme Court, the Court is considering whether the State or the municipal governments have the proper authority to plan and regulate basic sanitation services rendered in metropolitan regions, as well as the right to execute concession and program agreements. If the Brazilian Supreme Court grants this authority to municipal governments, under certain circumstances, we may be required to cease our operations in certain metropolitan regions where we have agreements with the State only, to the extent that those municipalities opt to use another water and sewage service provider. To mitigate this risk, we have commenced a process of executing agreements with both the State and the municipal governments of certain metropolitan regions, and we already have such agreements regarding the city of São Paulo. We cannot anticipate the effects of the Brazilian Supreme Court decision on the provision of our services in other metropolitan regions, which could have a material adverse effect on us.

We have not entered into formal agreements for the provision of water and sewage services with certain of the municipalities we serve, including municipalities in metropolitan regions, as required by the Basic Sanitation Law, and therefore we may not be able to enforce our rights to continue to provide services in these municipalities.

Under the Basic Sanitation Law, we were required to have entered into formal agreements before December 31, 2010 with every municipality with which we did not have a formal agreement in place or with which our agreements had already expired, as is the case of certain municipalities located in the metropolitan regions where we are authorized to operate in accordance with local legislation. If such contractual arrangements were not entered into by December 31, 2010, the informal or expired services concessions would no longer be valid.

As of the date of this annual report, of the 363 municipalities we provide water and sewage services to, we have informal or expired arrangements with 99 municipalities. These 99 concessions include municipalities located in and outside metropolitan regions, including the municipality of Santos, located in the coastal region. Together, these 99 municipalities accounted for 23.8% of our total revenues for the year ended December 31, 2011, and 29.7% of our intangible assets as of that same date.

We are currently negotiating with these municipalities the renewal or the formalization of the concessions through the execution of program agreements. In order to renegotiate or formalize the agreements, we face the following problems: (i) we are still awaiting the final decision of the Brazilian Supreme Court regarding whether the State or the municipalities have the right to enter into contractual arrangements for the provision of the basic sanitation services in the metropolitan regions (until the execution of the agreement with the city and State of São Paulo in June 2010 there was no precedent for a joint management contractual arrangement between the State, the municipalities and us); (ii) the execution of new agreements will depend on certain acts that are beyond our control, such as the compliance by the municipalities located outside the metropolitan regions with certain legal procedures.

The Basic Sanitation Law did not define any penalty for the non-compliance with the December 31, 2010 deadline by the municipalities or for the water and sewage service companies in case the deadline is not observed. Consequently, we cannot anticipate if we are going to be subject to any penalty due to the lack of a formal agreement with some municipalities or if any eventual penalty will have a material adverse effect on us.

We cannot assure you when or whether there will be changes to the conditions under which we currently provide water and sewage services to the municipalities with which we do not have formal concession agreements or are renegotiating expired agreements, or whether we will be able to continue to provide water and sewage services in any municipalities where we are unable to renew or enter into a formal concession agreement. Because we do not hold concessions or contractual rights to provide services in 99 municipalities, we may not be able to effectively enforce our right to continue to provide services therein or may face difficulties in being timely paid for the services that we provide.

In addition, in the future, our rights in respect of these municipalities could be modified or adversely affected by Brazilian federal, state or municipal governmental actions, judicial decisions or other factors. For further information, see “Item 4.B. Business Overview—Government Regulation—The Basic Sanitation Law” and “Item 4.B. Business Overview—Government Regulation—Concessions—Public Consortia and Cooperation Agreement Law for Joint Management.”

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

Our industry is specifically affected by the following risks associated with the provision of water and sewage services:

- we are subject to substantial charges imposed by state and federal government agencies that manage water resources related to the abstraction of water from, or dumping of sewage into, water bodies, which we may not be able to pass on to our customers. See "Item 4.B. Business Overview—Government Regulation—Water Usage;"

- in some cases, we are required to continue providing services to certain municipalities to which we provide water on a wholesale basis that have overdue amounts owed to us and are not paying us on a regular basis and we cannot assure you of when or whether these municipalities will pay us in a timely manner. See "Item 4.B. Business Overview-Billing Procedures;"

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

- our tariffs may not increase in line with increases in inflation and operating expenses, including taxes, or increase in a timely manner, which may hinder us from passing on to our customers increases in our cost structure. See "—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". These constraints may also 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;"

- we are exposed to probable increases in the frequency of extreme weather conditions in the future, which may adversely affect both the quality and quantity of waters available for abstraction, treatment, and supply. Given that our financial performance is closely linked to climate patterns, 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 distribution services. An increase in heavy rainfalls could impact water quality and regular operations 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);" and

- we are dependent upon energy to conduct our operations and eventual 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 to our customers significant increases in energy tariffs. See "Item 4.A. History and Development of the Company-Energy Consumption."

The occurrence of any of the above may have a material adverse effect on us.

We may face difficulties in continuing to provide water and sewage services in the municipalities we serve and we cannot assure you that these municipalities will continue to require our provision of services under the same terms.

As of December 31, 2011, we were a provider of water and sewage services to 363 municipalities. Between January 1, 2007 and December 31, 2011, we had entered into 30-year agreements with 225 of these municipalities (including our services agreement with the city of São Paulo), of which 25 were entered into in 2011. These 225 municipalities accounted for 65.2% of our total revenues for the year ended December 31, 2011 and 62.6% of our intangible assets as of December 31, 2011. As of December 31, 2011, we have been renegotiating 99 concession agreements that expired, including the municipality of Santos. Together, these 99 municipalities accounted for 23.8% of our total revenues for the year ended December 31, 2011 and 29.7% of our intangible assets as of that same date.

From January 1, 2012 to 2033, 39 concession agreements will expire. These 39 concession agreements accounted for 8.6% of our total revenues for the year ended December 31, 2011 and 6.7% of our intangible assets as of that same date.

We cannot assure you that these municipalities will continue to require our services and enter into new concession agreements or program agreements with us. In the event that we are successful in renegotiating our concession agreements or entering into program agreements with the municipalities whose concession agreements expired or will

expire, we cannot assure you that the new concession or program agreements will have the same terms under which we currently provide services to these municipalities. 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 the ARSESP.

In addition, these municipalities may choose to assume the direct provision of water and sewage services or promote a public bidding process to select another water and sewage service provider. Depending on the eligibility requirements to participate in the public bidding processes, we may not qualify to participate in some or all of these public bidding processes. If we participate in these public bidding processes, we cannot assure you that we will win the bid. In the event that these municipalities assume the direct provision of water and sewage services or promote a public bidding process to select another water and sewage service provider, or the new terms or conditions of the concession or program agreements are less favorable to us, we may be materially and adversely affected. See "Item 4.B. Business Overview—Our Operations" and "Item 4.B. Business Overview—Government Regulation—Concessions—Public Consortia a Cooperation Agreement Law for Joint Management."

Municipalities may, under certain circumstances, terminate our concessions before their expiration and the indemnification may be inadequate to recover the full value of our investments.

The concessions we hold are subject to early termination provisions, which entitle municipalities to terminate our concessions prior to their expiration date under certain circumstances. Municipalities may terminate our concessions if we fail to comply with our obligations under the relevant concession agreement or applicable law, or if the municipality determines, through an expropriation proceeding, that terminating our concession prior to its expiration date is in the public interest. If any municipality terminates our concession before the expiration date, we are entitled to be indemnified for the unamortized portion of our investments, but the indemnification may not be sufficient for us to recover the full value of our investments. Further, under the terms of the Constitution of the State of São Paulo, municipalities may pay the indemnification over a term of 25 years. However, the Brazilian Supreme Court stayed the application of this provision of the Constitution of the State of São Paulo in 1997, and the decision remains valid until final judgment.

In 1997, the municipality of Santos enacted a law expropriating our water and sewage systems in Santos. There are pending legal proceedings concerning the expropriation carried out by this municipality. We continue to provide water and sewage services to the city of Santos.

In 1995, the municipality of Diadema terminated the concession agreement that had been entered into with us prior to the expiration of the concession agreement. As a result, we filed a lawsuit against the municipality of Diadema which we eventually settled in 1996. The municipality of Diadema did not comply with this 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, formerly known as the State Secretariat for Sanitation and Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*). This memorandum establishes our agreement to conclude negotiations and settle all outstanding amounts and stay the collection proceedings we filed against the municipality of Diadema. In 2011, the municipality of Diadema agreed with us to develop a shared infrastructure for the provision of water and sewage services through a mixed-capital company called Companhia de Agua e Esgoto de Diadema, or CAED, and we cannot predict when this company will begin operations. The amount owed to us by the Diadema municipality would be returned to us through our capital participation in CAED. We can give no assurance that we will recover our investments in such company.

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

We cannot assure you that other municipalities will not seek to terminate their concession agreements before the contractual expiration date. The early termination of concession agreements by municipalities, our inability to receive adequate indemnification for the investments we made, or the payment of indemnification due to us over a long period, may have a material adverse effect on us.

The Basic Sanitation Law has established provisions governing the indemnification of water and sewage service providers in case of early termination of concession agreements by a municipality and reduced the term over which indemnification must be paid to four years. These provisions are also applicable to concession agreements entered into prior to the enactment of the Basic Sanitation Law, as long as these concession agreements do not have a contractual indemnification provision in case of early termination or we have not otherwise entered into an agreement with the municipality with regard to such early termination. Nevertheless, we cannot anticipate the effects of the Basic Sanitation Law on the amount of, and enforceability of the right to, indemnification and how Brazilian courts will enforce the provisions of the Basic Sanitation Law.

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

Our capital expenditure program will require substantial liquidity and capital resources of approximately R$7.9 billion in the period from 2012 through 2015. We recorded R$2.4 billion of capital expenditure in 2011 in connection with our capital expenditure program.

We have funded in the past, and we plan to continue to fund these expenditures with funds generated by operations and domestic and foreign currency borrowings on acceptable terms. A significant portion of our financing needs have been funded by lenders controlled by the federal government. We also benefit from long term financing from domestic and international multilateral agencies and development banks at attractive interest rates. Changes in the policies of the federal government regarding the financing of water and sewage services, or our failure to continue to benefit from long-term financing from domestic and international multilateral agencies and development banks at attractive interest rates may impair our ability to meet our obligations or finance our capital expenditure program, which could have a material adverse effect on us.

As a general rule, financial institutions and other institutions authorized to provide credit by the Central Bank may only provide loans to public sector entities, such as us, up to a certain percentage of the entity's shareholders' equity. Because of these limitations on our ability to obtain credit from domestic financial institutions, our options for raising funds, other than the cash generated by our operations, consist mainly of borrowing from governmental agencies, national and international financial institutions or multilateral agencies and issuing debt securities in both the domestic and international capital markets. These legal limitations could adversely affect our ability to continue our capital expenditure program.

We are also subject to financial covenants limiting our ability to incur additional indebtedness, 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 impair our ability to finance our capital expenditure program, which could have a material adverse effect on us.

We are subject to cost increases to comply with environmental law requirements and potential environmental liability that could have a material adverse effect on us.

Our facilities 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 establish potability standards for consumption and limit or prohibit emissions or spills of effluents, such as raw sewage, produced in connection with our operations. We could be subject to civil public actions and criminal, administrative and other civil proceedings for non-compliance with environmental laws and regulations, which could expose us to administrative and civil penalties and criminal sanctions, such as fines, closure orders and significant indemnification obligations. Since environmental laws and their enforcement by Brazilian authorities are becoming more stringent, our capital expenditures and expenses for environmental compliance may increase substantially. Expenditures required for compliance with environmental laws and regulations may result in reductions in other strategic investments that we have planned, which could negatively affect us. In addition, due to more stringent enforcement of environmental laws by Brazilian courts, we may be required to pay substantial fines and indemnifications in amounts that may vary widely from those currently anticipated. We are presently a party to a number of civil public actions and administrative proceedings related to environmental matters, with regard to which we are unable to calculate our estimated amount of potential liability. Any unfavorable judgment in relation to these lawsuits and proceedings or any material unforeseen environmental liabilities may have a material adverse effect on us. For further information on these lawsuits, see "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings."

The enactment of 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.

As new laws and regulations relating to climate change, including carbon controls, become applicable to us, and as existing environmental regulations relating to climate change become more stringent, it is possible that our capital expenditure for compliance with these laws and regulations will increase substantially in the future. If we increase capital expenditure to comply with these laws and regulations, we may be required to reduce expenditure on other strategic investments.

In addition, if climate change leads to significant physical effects, such as variations in the intensity of droughts and rain, our services may be affected and we may be required, among other things, to: (i) make significant investments in seeking new water sources located further from major consumer centers and (ii) make significant investments in new technologies.

We have not adopted any method for calculating the investments that would be necessary in the event of a significant physical effect from climate change. Any substantial increase in expenditure related to climate change, whether for compliance with environmental regulations or for preventing or remedying the physical effects of climate change, may have a material adverse effect on us. See "Item 4.B. Business Overview—Environmental Matters—Climate Change Regulations: Reduction of Greenhouse Gases (GHG)."

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

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, civil, environmental, tax, labor, condemnation and other proceedings. As of December 31, 2011, the total value of all outstanding claims was R$24,152.0 million (net of R$133.1 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 us. Based on advice from our legal counsel, we have provisioned a total aggregate amount of R$1,571.8 million (net of court deposits) as of December 31, 2011 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

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 that trade in emerging markets, such as Brazil, often 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 53.1% of the aggregate market capitalization of the BM&FBOVESPA as of December 31, 2011. The top ten stocks in terms of trading volume accounted for approximately 50.4%, 48.8% and 47.0% of all shares traded on the BM&FBOVESPA in 2009, 2010 and 2011, respectively.

Investors who exchange ADSs for common shares may lose their ability to remit foreign currency abroad and to obtain 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 the disposition of our common shares. If an ADR holder decides to exchange ADSs for the underlying common shares, this 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 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, dated January 26, 2000, of the CMN, 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, this 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. 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.

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 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 the 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 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 application of *Novo Mercado* rules, Brazilian Corporate Law and the application of the rules and regulations regarding Brazilian capital markets 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 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 ADSs only in accordance with the deposit agreement relating to our ADSs. There are no provisions under Brazilian law or under our bylaws that limit the exercise by ADR holders of their voting rights through the depositary with respect to the underlying common shares. However, there are practical limitations upon the ability of ADR 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. 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 will, in turn, as soon as practicable thereafter mail to ADR holders the notice of the meeting and a statement as to the manner in which instructions may be given by holders, but only if we request the depositary to do so. To exercise their voting rights, ADR 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 ADR 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.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Overview

Companhia de Saneamento Básico do Estado de São Paulo – SABESP is a mixed capital company (*sociedade de economia mista*) with limited liability. We were incorporated on September 6, 1973 under the laws of the Federative Republic of Brazil. We are registered at the Commercial Registry of the State of São Paulo (*Junta Comercial do Estado de São Paulo*) under registration number NIRE 35300016831. 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 service of process in the United States is CT Corporation System, with offices at 818 West Seventh Street – Team 1, Los Angeles, CA 90017. We are allowed to operate, in a subsidiary form, in other Brazilian locations and abroad. See "Item 4.B. Business Overview—Government Regulation—Concessions—Public Consortia and Cooperation Agreement Law for Joint Management."

We believe we are one of the largest water and sewage service providers in the world (based on the number of customers in 2011), according to the 13th edition of the *Pinsent Masons Water Yearbook (2011-2012)*. We operate 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 IBGE, the State of São Paulo is Brazil's most populous state and the state with the highest gross domestic product, or GDP, in Brazil. For the year ended December 31, 2011, from our total revenues we had a consolidated net revenue of R$9,941.6 million and a consolidated net income of R$1,223.4 million. Our total consolidated assets was R$25,215.0 million and our total shareholders' equity was R$10,545.9 million as of December 31, 2011.

As of December 31, 2011, we provided water and sewage services to a broad range of residential, commercial, industrial and governmental customers in 363 of the 645 municipalities in the State of São Paulo, including the city of São Paulo. Substantially all of our concessions or program agreements have 30-year terms. 99 of these concessions have expired and are currently being renegotiated. From January 1, 2012 through 2033, 39 concessions will expire, which we will seek to replace with program agreements.

We also supply water on a wholesale basis to six municipalities located in the São Paulo metropolitan region and to the municipality of Sumaré (with a total estimated urban population of approximately 3.7 million), in which we do not operate water distribution systems. Within these municipalities, five of them utilize our sewage treatment services. For the year ended December 31, 2011, the São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis) and the Regional Systems accounted for 73.9% and 26.1% of our gross revenue from sales and services (excluding revenues relating to the construction of concession infrastructure), respectively.

As of December 31, 2011, we provided water services through 7.5 million water connections to approximately 23.9 million people, representing approximately 59.0% of the urban population of the State of São Paulo, and effectively had a water coverage ratio of approximately 100% in respect of all regions. As of that date, we provided sewage services through 5.9 million sewage connections to approximately 20.5 million people and effectively had a sewage coverage ratio of 82.0%. As of December 31, 2011, we operated through 66,389 kilometers of water pipes and mains and through 45,073 kilometers of sewer lines.

We also provide water and/or sewage services to four other municipalities through special purpose companies. In addition, we render consulting services related to the rational use of water and commercial and operational management in Panama and Honduras through a partnership with Latin Consult.

The State, our controlling shareholder, is required by law to own at least 50% plus one of our common shares. As of April 23, 2011, the State owned 50.3% of our outstanding common shares. As a mixed capital company, we are an integral part of the State governmental structure. Our strategy and major policy decisions are formulated in conjunction with the State Secretariat for Sanitation and Water Resources as part of the overall strategic planning for the State. The majority of the members of our board of directors and our board of executive officers are nominated by the State government.

In addition, our capital expenditure budget is subject to approval by the State legislature and is approved in conjunction with the budget of the State Secretariat for Sanitation and Water Resources as a whole. Our consolidated financial statements and accounting records are subject to review by the State Accounts Tribunal (*Tribunal de Contas*), as are all accounts of the State.

Our Strengths

We believe that our strong business position and future prospects relate to the following strengths:

Well-established business with significant size, scale and know-how to operate in complex urban settings. We believe we are one of the largest water and sewage service providers in the world. We provide water services directly to approximately 23.9 million people and supply water on a wholesale basis to an additional urban population of 3.7 million people. As of December 31, 2011, we effectively had a water coverage ratio of approximately 100% in respect of all regions in which we operate. We also provide sewage services directly to approximately 20.5 million people, achieving a sewage coverage ratio of 82.0% in respect of all regions in which we operate as of December 31, 2011. During the year ended December 31, 2011, our net revenue from sales and services increased by 7.7% as compared to the year ended December 31, 2010 (including revenues relating to the construction of concession infrastructure). Our significant size and scale have required us to operate in complex urban settings such as *favelas* (shantytowns) and environments without urban planning, which has enabled us to develop skills to operate in adverse conditions and have well-trained personnel and a specialized structure that we believe our competitors lack.

Operations in Brazil's most populous and wealthy state. The State of São Paulo, part of the most developed and economically active region of Brazil, is the most populous state in Brazil, with an estimated population of 43.0 million as of December 31, 2011. The city of São Paulo had an estimated population of 11.0 million as of that date, with 20.4 million inhabitants in the São Paulo metropolitan region. Based on its GDP, the State of São Paulo is the wealthiest state and largest economy in Brazil. The GDP of the State of São Paulo was approximately R$1.1 trillion in 2009, representing approximately 33% of Brazil's total GDP. The State of São Paulo generates more revenue from water and sewage services than any other Brazilian state.

Strong Contract Log. From the 363 municipalities we serve, in the last five years, we have executed 30-year agreements with 225 of them, including an agreement with the municipality of São Paulo entered into in June 2010. As of December 31, 2011, the income from those 225 municipalities in which we have long-term contracts accounted for 65.2% of our revenues.

Access to low-cost and diverse sources of financing. Our strong cash flow generation from operations and our role as an essential public service provider places us in a privileged position in our industry to obtain low cost, long-term financing from Brazilian public banks, and domestic and international multilateral agencies and development banks. In addition, we are not dependent upon a limited number of sources of financing. We benefit from various funding alternatives available in the Brazilian and international markets for our working capital needs and our capital expenditure programs.

Strong corporate governance practices. In 2002, we joined the *Novo Mercado* segment of the BM&FBOVESPA, which is the listing segment in Brazil with the highest corporate governance requirements. As a result, we are committed to maintaining certain additional corporate governance practices that are not required by Brazilian law, ensuring additional protection to our shareholders rights and enhancing the quality of information we disclose to the market. On December 1, 2007, we became part of the BM&FBOVESPA Corporate Sustainability Index, or ISE, which reflects our high degree of commitment to sustainable environmental and social practices.

High quality operations. We believe that we adhere to high standards of service and utilize the best available technology in the sanitation business to control the quality of the water captured, produced and distributed. All of our water quality control laboratories operate in accordance with the ABNT NBR ISO 9001, which follows the highest international water quality standards. In addition to our central laboratory, 11 of our regional laboratories are accredited by the National Institute of Metrology, Standardization and Industrial Quality, or INMETRO, thereby assuring the quality and accuracy of our test results, according to ABNT NBR ISO IEC 17025. Moreover, our laboratories and field teams use the latest equipment to detect substances controlled by regulations and have highly trained teams to handle contingencies and customer complaints. We believe our technology enhances the efficiency and quality of our operations. As of December 31, 2011, 50 of our sewage treatment facilities had obtained the ISO 14001 certification.

Our Strategy

Our mission is to provide water and sewage services, contributing to the improvement of the quality of life and of the environment. To this end, our strategic objectives are based upon the guiding principles of growth, quality, universalization of sanitation services and social, economic and environmental sustainability, while focusing on reaching excellence on costumer service. We also base our strategic objectives on our political and institutional relationships as well as on our commitment to the market to increase shareholder value. We seek to implement these guiding principles through the following strategies:

Continue to seek growth while improving our financial results by reducing operating costs, increasing productivity and profitability and prudently managing our levels of indebtedness. We aim to apply our principles of financial growth and sustainability to each business unit, assigning goals and setting clear responsibilities to each unit so as to reach better financial results. To achieve this goal, we intend to use our best efforts to reduce operating costs and increase productivity and profitability. We plan to improve the management of our assets, as well as to continue to reduce our total operating expenses by automating some of our facilities, streamlining operational processes, implementing integrated planning and further investing in internal technological research and development. We also plan to continue our efforts to improve our collection of overdue accounts receivable from municipalities to which we provide services, from the State and from other governmental entities, including by exploring opportunities to offset these outstanding debts against certain possessory or property rights over utilities relating to water and sewage systems. We intend to continue to fund our working capital needs and estimated capital expenditure programs with diversified sources of financing, such as domestic and international development banks and multilateral agencies. We will continue to seek market opportunities for low-cost financing and restructuring of our indebtedness if and when advantageous and appropriate.

Improve operating efficiency and reduce water losses. We seek to reduce both physical water losses, which result mainly from leakage, and non-physical water losses, which result primarily from the inaccuracy of our water meters installed at our customers' premises and at our water treatment facilities, and from clandestine and illegal use. In order to achieve more consistent long-term results, we have developed a comprehensive 11-year program to reduce our water loss rate. The first three years of the program from 2009 to 2011 was funded by the BNDES. During 2012 to 2016 the program is being also funded by a loan granted by the government of Japan through the Japan International Cooperation Agency, or JICA. The program's focus is on the renewal of our water distribution infrastructure and the improvement of maintenance and control services as a means of reducing physical water losses. We are also seeking to reduce physical water losses by creating smaller water supply districts through the construction of district metering areas, or DMAs, that reduce the system's pressure and pipe bursts, allowing leaks to be detected and repaired more efficiently. The program also seeks to reduce non-physical water losses by upgrading and replacing inaccurate water meters and through inspections of non-authorized water consumption in water service connections.

Ensure the quality and availability of our services in our existing service area. Our goal is to maintain an effective water coverage ratio of around 100%, coupled with a high standard of quality and availability and meet the expected population growth by adding 1.3 million water connections from 2012 to 2019. We also intend to increase our sewage coverage ratio to 95% by 2019 by adding 1.8 million sewage connections. In addition, we are also developing short, medium and long term marketing strategies, such as client segmentation and tailor made solutions for each type of client, which we believe will help us increase our customer base. We also seek to improve our costumer support strategies by modernizing our telephone and internet-based costumer support and continuously measure the level of satisfaction of our clients.

Maintain and continue to expand our existing service areas. We intend to maintain our operating base through the execution of new agreements. To this end, we are actively seeking to develop closer relationships with the municipal governments that we currently serve in order to increase customer loyalty and thereby renew all or substantially all our expiring concession agreements. In June 2010, we entered into an agreement with the State and city of São Paulo with a 30-year term for the provision of water and sewage services in the city of São Paulo, which in the year ended December 31, 2011 accounted for 55.1% of our gross revenues from sales and services (excluding revenues relating to the construction of concession infrastructure). Between January 1, 2007 and December 31, 2011, we entered into 225 agreements with 30-year terms with municipalities (including our services agreement with the city of São Paulo), of which 25 were entered into in 2011. These 25 municipalities accounted for 2.9% of our total revenues for the year ended December 31, 2011 and 3.3% of our intangible assets as of that same date. As of December 31, 2011, 99 of our concessions had expired and are currently being renegotiated. These 99 municipalities accounted for 23.8% of our total revenues for the year ended December 31, 2011 and 29.7% of our intangible assets as of that same date. From January 1, 2012 through 2033, 39 concession agreements accounting for 8.6% of our revenues for the year ended December 31, 2011 and 6.7% of our intangible assets as of December 31, 2011 will expire.

We have also developed a platform to offer unique services relating to sustainability, environmental preservation and water resource management to our large industrial, commercial and residential customers in order to encourage these customers to continue to use our water services. We also intend to continue to expand our sewage services. A significant portion of our capital expenditure program, of approximately R$7.9 billion between 2012 and 2015, is designed to achieve this goal. We also regularly explore the possibility of executing agreements for the provision of water and sewage services in municipalities of the State of São Paulo in which we currently have no operations or to which we currently supply water and provide sewage treatment solely on a wholesale basis, representing a total population of approximately 17 million. We evaluate possible expansion opportunities in terms of proximity to our existing service areas to maximize return on investment and improve our financial performance. We also intend to study, and take advantage of, opportunities in other Brazilian states and in other countries to expand our services and increase our market share.

Expand our water and sewage services. We had a sewage coverage ratio of 82.0% as of December 31, 2011, and we plan to increase our sewage coverage ratio to 95% by 2019, by adding over 1.8 million sewage connections. In addition, there are municipalities in the State of São Paulo representing an aggregate population of approximately 17 million to which we currently do not provide water or sewage services, or to which we currently supply water solely on a wholesale basis. Our strong presence in the State and experience in providing water and sewage services places us in a privileged position to expand our sewage services to municipalities in which we provide only water services and our water and sewage services to municipalities in which we do not yet operate, in both the State of São Paulo and also in other states in Brazil and abroad. Further, we seek to deepen our relationships with strategic clients that consume high volumes of water (more than 500 cubic meters per month) by applying special tariffs for these clients.

Seek selective opportunities to expand our business. In 2007, a change in our bylaws expanded the scope of our corporate purpose to include activities complementary to our water and sewage services, such as urban rainwater management and drainage services, urban cleaning services and solid waste management services. Since then we have:

- executed cooperation agreements to exchange technology with six regional basic sanitation companies in Brazil, as well as with international businesses such as Mekorot National Water Company, an Israeli company, Sociedade General Aguas de Barcelona S/A – Agbar, a Spanish company, Instituto Costarricence de Acueductos y Alcantarillados, a Costa Rican company, Empresa Pública de Medellin, a Colombian municipal multi-utilities company and Agua y Saneamientos Argentinos - AYSA, an Argentine company, which will allow us to exchange know-how and learn about future opportunities;

- executed memoranda of understanding with three municipalities to study the possibility of operating landfills;

- created four special purpose companies (SESAMM – Serviços de Saneamento de Mogi Mirim S/A; Águas de Castilho S.A.; Águas de Andradina S.A.; and Saneaqua Mairinque S.A.) to operate water and/or sewage concessions granted by four municipalities in the State of São Paulo;

- executed an agreement with the Servitec/Tecniplan consortium for the use of small hydroelectric power plants in our water treatment stations in Guaraú and Vertedouro Cascata;

- executed an agreement with the basic sanitation company of the state of Alagoas to transfer technology for the reduction of water losses in the city of Maceió;

- executed a service agreement with the basic sanitation company of the state of Espírito Santo to license the use of our proprietary software “Aqualog” designed to remotely monitor water treatment;

- won two international public biddings for the provision of: (i) consulting services relating to a program for the rational use of water and for the implementation of a new model for commercial and operational management of the Instituto de Acueductos y Alcantarillados Nacionales, the company responsible for the provision of the water and sewage services in the central provinces of Panama, and (ii) consulting services for the implementation of a new model for commercial and operational management in nine municipalities of Honduras;

- created a special purpose company (Aquapolo Ambiental S.A.), in partnership with a private sanitation services operator, to build and operate the largest water recycling facility in the southern hemisphere, which will supply up to 1,000 liters per second to industries in the São Paulo metropolitan region;

- rendered consulting services relating to the Municipal Basic Sanitation Plan to the municipality of Barro Alto, located in the State of Goiás; and

- created a special purpose company (ATTEND), in partnership with Estre Ambiental S.A., for the implementation of a structure to receive non-domestic water resources in the municipality of São Paulo, which will also have a pre-treatment water station.

In addition, in connection with the expansion of our business, we are evaluating and may consider creating an investment vehicle, Sabesp Participações, through which we may make equity investments.

We intend to continue to selectively seek new business opportunities to take advantage of our know-how, size and scale.

Establish efficient and competitive ways of attracting, retaining and motivating our personnel. We intend to become a reference in human resource management, providing our personnel with growth opportunities and recognition. We seek to raise workplace satisfaction levels by establishing programs for the professional and personal development of employees, particularly of those in managerial positions, setting attractive compensation packages and creating a healthy and collaborative work environment.

We believe that our overall strategy will enable us to meet the demand for high quality water and sewage services in the State of São Paulo, in other Brazilian states and abroad, while strengthening our results of operations and our financial condition and creating shareholder value.

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 of São Paulo is located in the southeastern region of the country, which also includes the States of Minas Gerais, Espírito Santo and Rio de Janeiro, and which is, according to IBGE, the most developed and economically active region of Brazil. The State of São Paulo is located on the Atlantic coast of Brazil, with the States of Rio de Janeiro and Minas Gerais to the north, the State of Paraná to the south and the State of Mato Grosso do Sul to the west.

The State of São Paulo occupies 3.0% of Brazil's land mass and encompasses an area amounting to approximately 96,000 square miles. According to the SEADE, the State of São Paulo had an estimated total population of 43.0 million as of December 31, 2011. The city of São Paulo, the State of São Paulo's capital, had an estimated population of 11.0 million, with 20.4 million inhabitants in the São Paulo metropolitan region, as of December 31, 2011. The São Paulo metropolitan region encompasses 39 cities and is the largest metropolitan region in the Americas and the third largest metropolitan region in the world, according to the United Nations' World Urbanization Prospects, 2009 Revision. The São Paulo metropolitan region accounted for approximately 47% of the population of the State of São Paulo as of December 31, 2011.

According to the IBGE, the GDP of the State of São Paulo was approximately R$1.1 trillion in 2009, representing approximately 33% of Brazil's total GDP, and making it the largest economy of any state in Brazil based on GDP. According to the IBGE, the State of São Paulo is also the leading Brazilian state in terms of manufacturing and industrial activity, with a strong position in car manufacturing, pharmaceuticals, computer manufacturing, steel making and plastics, among other activities, as well as a leading position in the banking and financial services industries. The State of São Paulo is the most important exporting state in Brazil, according to the Brazilian Ministry of Development, Industry and Foreign Trade (*Ministério do Desenvolvimento, Indústria e Comércio Exterior*).

History

Until the end of the nineteenth century, water and sewage services in the State of São Paulo were generally provided by private companies. In 1875, the Province of São Paulo granted a concession for the rendering of water and sewage services to *Companhia Cantareira de Água e Esgotos*. In 1893, the government of the Province of São Paulo assumed responsibility for the rendering of water and sewage services from *Companhia Cantareira de Água e Esgotos* and formed the Office of Water and Sewers (*Repartição de Água e Esgotos*), a governmental agency. Since that time, water and sewage services in the São Paulo metropolitan region have been administered by the State government. Historically, water and sewage services in substantially all other municipalities of the State were administered by the municipalities directly either by municipal water and sewage departments or through *autarquias* of the municipal government. *Autarquias* are relatively autonomous public bodies with separate legal standing, assets and revenues, created by law to undertake administration of public services, which are considered to be better managed by a decentralized administrative and financial structure.

In 1954, in response to dramatic population growth in the São Paulo metropolitan region, the State government created the Department of Water and Sewers (*Departamento de Águas e Esgotos*), as an *autarquia* of the State. The Department of Water and Sewers provided water and sewage services to various municipalities in the São Paulo metropolitan region.

A major restructuring of the entities providing water and sewage services in the State of São Paulo occurred in 1968, with the creation of the Water Company of the São Paulo Metropolitan Region (*Companhia Metropolitana de Água de São Paulo*), or the COMASP, the purpose of which was to provide potable water on a wholesale basis for public consumption in the municipalities of the São Paulo metropolitan region. All assets relating to the production of potable water for the São Paulo metropolitan region previously owned by the Department of Water and Sewers were transferred to COMASP. In 1970, the Superintendence of Water and Sewers of the city of São Paulo (*Superintendência de Água e Esgoto da Capital*), or the SAEC, was created by the State government to distribute water and collect sewage in the city of São Paulo. All assets previously owned by the Department of Water and Sewers in connection with the water services were transferred to the SAEC. Also in 1970, the State created the Basic Sanitation Company of the São Paulo Metropolitan Region (*Companhia Metropolitana de Saneamento de São Paulo*), or the SANESP, to provide sewage treatment services for the São Paulo metropolitan region. All assets previously owned by the Department of Water and Sewers in connection with the sewage services were transferred to the SANESP. The Department of Water and Sewers was subsequently closed.

On June 29, 1973, pursuant to State Law n. 119, COMASP, the SAEC and the SANESP merged to form our Company with the purpose of implementing the directives of the Brazilian government set forth in the National Water Supply and Sanitation Plan (*Plano Nacional de Saneamento*). We were incorporated under the laws of Brazil as a limited company (*sociedade anônima*), for indefinite duration. The National Water Supply and Sanitation Plan was a program sponsored by the Brazilian government, which financed capital investments in, and assisted in the development of, state-controlled water and sewage companies. Since our formation, other State governmental and State-controlled companies involved in water supply and sewage collection and treatment in the State of São Paulo have been merged into us and the State has been our controlling shareholder as required by State Law n. 119. We thus have been integrated into the State governmental structure and our strategies have been formulated in conjunction with the strategies for the State Department of Water Resources and Sanitation. Additionally, most members of our Board of Directors and our management are appointed by the State Government.

The budget for our capital expenditures is subject to approval of the State legislative chamber. This approval is obtained simultaneously with the approval of the budgets of the Department of Sanitation, of the Department of Energy and of the State of São Paulo. The Company is also subject to supervision from the Court of Audit of the State of São Paulo ("*Tribunal de Contas do Estado de São Paulo*"), with regard to our accounting, financial, budgetary, operational and assets.

We provide water and sewage services directly to a large number of residential, commercial and industrial private consumers, on top of to a variety of public entities in 363 of the 645 municipalities in the State, including in the city of São Paulo, as well as providing treated water on a wholesale basis to six municipalities located in the São Paulo metropolitan region and to the municipality of Sumaré, in which we do not operate the distribution systems to consumers. Among these municipalities, we also provide sewage treatment services to five of them. Currently, we are a leading provider of water and sewage services in the world in number of clients, according to the 13th edition of the Pinsent Masons Water Yearbook (2011-2012).

In 1994, we were registered with the CVM as a publically-held company subject to rules issued by the CVM, including those relating to the periodic disclosure of extraordinary facts or relevant events. Our common shares have been listed on the BM&FBOVESPA under the ticker "SBSP3" since June 4, 1997.

In 2002, we joined the *Novo Mercado* segment of the BM&FBOVESPA, which is the listing segment in Brazil with the highest corporate governance requirements. During that same year, we registered our securities with the Securities and Exchange Commission, or SEC, and started trading our shares in form of American Depositary Receipts – level III ("ADRs") on the New York Stock Exchange, or NYSE.

In 2004, a secondary offer of common shares held by the State of São Paulo was made simultaneously in the Brazilian and in the international market. On December 1, 2007, we became part of the BM&FBOVESPA Corporate Sustainability Index, or ISE, which reflects our high degree of commitment to sustainable environmental and social practices.

In December, 2007, Law No. 1,025 allowed for the creation of regulatory agencies for the supervision of water and sewage services. The same law created ARSESP, the regulatory agency that regulates and supervises the services we provide.

In July 2008, we announced that we would expand the area reached by our services, as well as including in our scope of services activities related to environmental and energy solutions, as required by the State Law No. 1,025. Since then, we have also been forming partnerships with private companies to consolidate our operations in the sanitation sector, in particular: (i) through a special purpose entity which provides services of water distribution and/or sewage

treatment for certain municipalities in the State; (ii) we entered into a consortium with the consultancy firm Latin Consult to provide consultancy services in certain cities in Panama and Honduras for the rational use of water and the adoption of a new commercial and operational management model; (iii) the production, supply and commercialization of reused water and (iv) the implementation and operation of a station for the preconditioning of non-domestic wastewater, sludge conditioning and other related activities.

Other partnership led to the creation of the following companies: Sesamm – Serviços de Saneamento de Mogi Mirim S.A., Águas de Andradina S.A., Saneáqua Mairinque S.A., Aquapolo Ambiental, S.A. Águas de Castilho S.A. e Attend Ambiental S.A. Although we do not necessarily hold a majority capital participation in these companies, shareholder agreements provide us with veto powers or qualified votes on certain matters those business associates may come across.

Corporate Organization

In 2005, we reorganized our corporate management structure. As a result, we currently have six management divisions, each of which is supervised by one of our executive officers.

The allocation of responsibilities among the executive officers is made by our board of directors, after an initial proposal made by the Chief Executive Officer, in accordance with our bylaws. The Chief Executive Officer is responsible for coordinating all management divisions in accordance with the policies and directives established by our board of directors and board of executive officers, including the coordination, evaluation and control of all functions related to Chief Executive Officer's office and staff, integrated planning, business management and organization, corporate communication, audit, ombudsman, and regulatory matters. The Chief Executive Officer represents our Company before third parties and some of its representation powers can be granted to attorneys-in-fact. The executive officers described below report to the Chief Executive Officer:

§ the Corporate Management Officer, who is responsible for marketing, human resources and quality control programs, legal affairs, information technology, asset management, legal and procurement, and contracts;

§ the Chief Financial Officer and Investor Relations Officer, who is responsible for financial planning, costs and tariffs, raising and allocating financial resources to all divisions within the Company, conducting capital markets and other indebtedness-related transactions and managing indebtedness levels, control department, accounting, corporate governance and investor relations;

§ the Technology, Enterprises and Environment Officer, who is responsible for the environmental planning and management, technological and operating, product quality control, developments and coordination and execution of special investment programs, projects and new businesses; and

§ the Chief Operating Officer of the São Paulo Metropolitan Region Division and the Chief Operating Officer of the Regional Systems Division, who are responsible for managing the operation, maintenance, execution of planning and works for the water and sewage supply systems including planning and works for our services rendered on a wholesale basis, sales and call center services, as well as the control of economic-financial and operational performance of its division. These Chief Operating Officers are also responsible for sanitation advisory services to autonomous municipalities and for the mediation and the negotiation with communities and local governments, aimed at aligning our interests with the interests of our clients.

Capital Expenditure Program

Our capital expenditure program is designed to improve and expand our water and sewage system and to increase and protect our water sources in order to meet the growing demand for water and sewage services in the State of São Paulo. Our capital expenditure program has four specific goals in the municipalities we serve: (i) to continue to meet the maximum demand for treated water; (ii) to expand the percentage of households connected to our sewage system; (iii) to increase the treatment of sewage collected; and (iv) to increase operating efficiency and reduce water losses.

From 2009 through 2011, our capital expenditure program totaled R$ 6.4 billion, primarily to build up our infrastructure and for our efforts to reduce water losses. We have budgeted investments in the amount of R$7.9 billion from 2012 through 2015. We invested R$1.8 billion, R$2.2 billion and R$2.4 billion in 2009, 2010 and 2011, respectively.

The following table sets forth our planned capital expenditures for water and sewage infrastructure for the years indicated.

Planned Capital Expenditures

	2012	2013	2014	2015	Total
			(in millions of reais*)*		
Water	745.9	599.2	607.2	579.6	**2,532**
Sewage	926.7	991.4	845.9	368.2	**3,132**
Others	336.5	395.4	504.9	988.2	**2,225**
Total	**2,009**	**1,986**	**1,958**	**1,936**	**7,889**

Our capital expenditure program from 2012 through 2015 will continue to focus on achieving our targets by making regular investments in and expanding our infrastructure as well as making investments in the reduction of water losses throughout the 363 municipalities we served as of December 31, 2011.

Main Projects of Our Capital Expenditure Program

The following is a description of the main projects in our capital expenditure program.

Metropolitan System Investment Program

Metropolitan Water Program

Demand for our water services has grown steadily over the years in the São Paulo metropolitan region and has exceeded at times the capacity of our water systems. As a result, prior to September 1998, part of our customers in this region received water only on alternate days of the week. We refer to this as "rotation." In order to remedy this situation, we implemented the Metropolitan Water Program (*Programa Metropolitano de Água*) to improve regular water supply to the entire São Paulo metropolitan region. This program terminated in 2000 and the rotation was eliminated, but we have maintained our investment projections for the region. During the second phase of the Metropolitan Water Program between 2006 and 2014, we plan to expand the infrastructure of water storage tanks by 210,000 cubic meters and to construct 44 water pumping stations and 240 kilometers of mains. The investment is expected to reach R$2.7 billion and the construction is expected to expand the water production capacity by 13.2 cubic meters per second until 2014. We have been working on this project since 2006, and we expect to complete it by 2014. In 2011, we invested approximately R$102.5 million, respectively, in this project.

The metropolitan region suffers from a water shortage, which requires us to obtain water from increasingly distant sources. In order to remedy this situation, we are currently developing a new supply system called São Lourenço that should be able to benefit a population of almost 1.5 million people. We have already concluded the project's conceptual studies and are currently developing its infrastructural projects. We may propose a Public Private Partnership to the government of São Paulo.

In June 2008, we entered into a Public Private Partnership (*Parceria Público-Privada*), or PPP, with Cab Spat, a special purpose company whose main shareholders are Cab Ambiental and Galvão Engenharia S.A. Cab Spat will be responsible for (i) expanding the Taiaçupeba water treatment plant capacity from ten cubic meters per second to 15 cubic meters per second, (ii) building 17.7 kilometers of water connections and mains, (iii) building four water storage tanks with total capacity of 70,000 cubic meters, (iv) installing boosters, and (v) building pumping stations. The total investment in projects to be undertaken by Cab Spat during the first two years of the PPP is estimated at R$320.0 million. Cab Spat will also perform maintenance on the dams of the Alto Tietê System, in connection with which Cab Spat will also provide civil engineering, electromechanical and operational services, as well as sludge treatment and the corresponding services regarding water adduction and water supply. The total value of the project is estimated at R$1.0 billion. We intend to pay these investments over 15 years upon the completion of the contracted projects and services. In December 2011, the services were concluded and the system's nominal capacity was increased from 10 to 15 cubic meters per second, directly benefiting 1.5 million people in the east region of the São Paulo metropolitan region, in addition to improving the reliability, flexibility and availability of the integrated water system that services the state's metropolitan region. The increase in production will improve the east, north and west regions water supply levels since it will be possible to transfer water from the east system to other localities. In 2011, we invested approximately R$ 121.4 million in this project.

Tietê Project

The Tietê river crosses the São Paulo metropolitan region and receives most of the region's run off and wastewater. The environmental status of the river reached a critical level in 1992. In an effort to reverse the situation, the State of São Paulo created a recovery program designed to reduce pollution of the Tietê river by installing sewage collection lines along the banks of the Tietê river and its tributaries. These lines collect raw sewage and deliver it to our sewage treatment facilities. We completed the first phase of the program between 1992 and 1998.

In connection with the first phase of the Tietê Project (*Projeto Tietê*), in June 1998, we completed the construction of three additional sewage treatment facilities and invested a total of US$1.1 billion, of which US$450.0 million was financed by the Inter-American Development Bank, or IADB, approximately US$100 million by the *Caixa Econômica Federal*, or the Caixa, and approximately US$550 million by us.

The second phase of the project was carried out from 2000 through 2008, with investments of approximately US$500 million, of which US$200.0 million were financed by the IADB, R$60.0 million by the BNDES, and R$180.0 million by the BNDES through another financial institution. In this phase, 290,000 sewage connections and more than 1,500 kilometers of sewage collections networks, branch collectors and interceptors were installed and/or built.

The main objective of this second phase was to continue expanding and optimizing the sewage systems of the São Paulo metropolitan region, primarily focusing on actions that allow for the delivery of a higher volume of raw sewage to the sewage treatment facilities that were built in the first phase of the Tietê Project. Upon the conclusion of the second phase of the project in 2008, we were able to collect approximately 5,000 liters of raw sewage per second and send it for treatment in the five sewage treatment plants of our integrated system. As part of the second phase of the Tietê Project, we implemented a geographic information system named SIGNOS. SIGNOS is a management information system which automates and integrates various business processes, including project management, maintenance, operations and customer service and maps out our entire municipal infrastructure in the São Paulo metropolitan region.

The first and second phases of the Tietê Project contributed to an increase from 70.0% to 84.0% in the sewage collection rate and an increase from 24.0% to 70.0% in the treatment of the sewage collected in the São Paulo metropolitan region. As a result, the sewage collection system benefited 15.8 million people (5.1 million more than the number of people served when the Tietê Project was initiated), and the sewage treatment benefited 11.1 million people (8.5 million more than the number of people served when the Tietê Project was initiated).

As of December 31, 2011, we owed US$386.9 million to the IADB for the financing it provided. For further information on the agreement entered into with the IADB, see "Item 5.B. Liquidity and Capital Resources—Capital Sources." We currently provide secondary treatment to approximately 68% of the sewage collected in the São Paulo metropolitan region. The five principal sewage treatment facilities in the São Paulo metropolitan region have an aggregate installed capacity of 18 cubic meters of sewage per second and currently treat an aggregate of 15.6 cubic meters of sewage per second. We plan to build additional collection lines to direct more raw sewage to our treatment facilities.

The third phase of the Tietê Project, designated as "the decontamination of the Tietê river," aims at contributing to the recuperation of the water quality of the Tietê river basin through the expansion of the level of collection to 87.0% and treatment of sewage to 84.0% in the São Paulo metropolitan region. The total estimated cost of the third phase is approximately US$1.1 billion, of which US$600.0 million will be financed pursuant to the IADB Loan entered into on September 3, 2010. The program plan of the third phase comprises mainly (i) drainage collection (collection networks and home connections), (ii) removal and transport of the drainage for treatment (branch collectors and interceptors), and (iii) the construction of sewage treatment plants, not only of the integrated drainage system of the São Paulo metropolitan region, but also of various isolated systems in the same region, during a six-year period from 2010 to 2016. Approximately 43% of the work is already under execution and 25% is undergoing public bidding processes. After the third phase of the Tietê Project, the sewage collection system will benefit an additional 1.5 million people and the sewage treatment will benefit an additional 3.0 million people.

We are currently planning the fourth and final phase of the Tietê Project, which should take place between 2013 and 2018. The main objective of the fourth phase if to completely end the dumping of untreated sewage into the Tietê river in the area in which we are the water services provider.

Corporate Program for Water Loss Reduction

The objective of the Corporate Program for Water Loss Reduction (Programa Corporativo de Redução de Perdas) is to decrease water losses more efficiently by means of the integration and expansion of the existing initiatives in our business units. We began structuring the program in the second half of 2007 and finalized it in 2008. We have invested R$1.0 billion in this project so far and anticipate investments of approximately R$4.3 billion throughout the program's 11-year term, beginning in 2009. Funding will come from our own resources as well as from loan agreements entered with the Japan International Cooperation Agency (JICA), with Caixa Econômica Federal and with BNDES. The program aims to reduce the incidence of water loss from 436 liters per connection per day in December 2008 to 211 liters per connection per day in 2019, which is equivalent to reducing water losses from 27.8% in December 2008 to 15.0% in 2019. This goal will be revised based on the results reached so far and the expected reduction with the implementation of the Corporate Program for Water Loss Reduction in the 2012-2019 period.

In 2011, we invested approximately R$326.7 million in this program. As of December 31, 2011, water losses were reduced to 25.6% from 26% in 2010.

New Life Program

The New Life Program (*Programa Vida Nova*) includes projects focused on the improvement and preservation of water reserves in the São Paulo metropolitan region and the urban development of the region, especially in the Guarapiranga and Billings mains. The resources will be mostly invested in the creation of infrastructure to collect sewage in the region, and to direct it to treatment plants, while avoiding its pouring directly into the springs. The program also includes protection activities of green areas and the urbanization of *favelas* (shantytowns) and is expected to directly benefit 50,000 families.

The State government, local authorities and the federal government will invest approximately R$1.3 billion in the program. We will fund this program with R$355.0 million. The State Secretariat for Sanitation and Water Resources coordinates the program with our involvement and that of the Urban Development Company of São Paulo (*Companhia de Desenvolvimento Habitacional e Urbano*), or the CDHU, and local governments in the region.

As of December 31, 2011, R$45.5 million have been invested in this program by us, of which R$29.4 million were invested in 2011.

Clean Stream Program

The Clean Stream Program (*Programa Córrego Limpo*) is a partnership between the State, through us, and the municipality of São Paulo, and aims to clean and decontaminate urban streams in the city of São Paulo, by improving the sewage sanitary system, the elimination of sewage through streams and rainwater galleries, the cleaning of streams and stream borders, as well as the removal and relocation of properties located in riverbanks. As of December 31, 2011, approximately R$129.5 million had been invested in this program and 103 urban streams had been decontaminated, benefiting approximately 1.7 million people.

In 2012, we expect to decontaminate 45 additional urban streams, benefiting over 700 thousand people. The estimated capital expenditures for this program in 2012 is R$36 million.

Regional Systems Investment Programs

We currently have a number of projects in progress and planned for the Regional systems, including projects relating to abstraction of water and collection, removal and final disposal of sewage. We invested R$1,091.0 million, R$943.7 million and R$1,109.2 millions, in these projects in 2009, 2010 and 2011, respectively, and we have budgeted for additional capital expenditures of approximately R$ 2.2 billion from 2012 through 2015.

Clean Wave Program

The main goals of the Clean Wave Program (*Programa Onda Limpa*) are to improve and expand the sewage systems in the municipalities comprising the Baixada Santista metropolitan region, increasing the sewage collection rate to 95.0%, and treating 100.0% of the collected sewage and thereby improving bathing water quality at 82 beaches in the region by 2013. On August 6, 2004, we entered into a credit agreement with the JBIC for the financing of this project, which is guaranteed by the Federative Republic of Brazil, for a total amount of R$382.8 million. On October 1, 2008, the JICA incorporated the loan transactions of the JBIC. For further information on the agreement entered into with the JICA, see “Item 5.B. Liquidity and Capital Resources—Capital Sources.” As of December 31, 2011, we had invested approximately R$1.6 billion in this program, R$ 159.8 million of which during the year 2011 . With the completion of construction of sewage treatment plants and installation of networks, we have prioritized the connection of costumers to the sewage collection system. Until the end of 2011, we had finished 63,000 connections of the total 123,000

expected.

Northern Coast Clean Wave Program

The Northern Coast Clean Wave Program (*Programa Onda Limpa Litoral Norte*) will expand the collection and treatment of sewage in the Northern coast of the State of São Paulo, intending to benefit 600 thousand people, including the local population as well as tourists that each year visit the region. By 2015, the program will increase the collection and treatment of sewage rate in the region from 36.0% to 85.0%, seeking to improve the health and well-being of the population, in addition to stimulating economic development through the increase in tourism in the region.

In 2011, we continued working on two sewage treatment plants in the city of São Sebastião and other sewage system projects in the cities of Ubatuba, Ilhabela and São Sebastião, which we expect to complete in 2013. Until 2011, R$114.6 million had already been invested in this program, of which R$ 24,6 million were invested in 2011.

Coastal Water Program

The Coastal Water Program (*Programa Água no Litoral*) is the main combination of long-term activities to expand water production capacity in the Baixada Santista metropolitan region and Southern Coast of the State of São Paulo. Almost three million people, including local population and tourists, are expected to benefit from this program. This program will enable us to increase the level of reliability of the systems, eliminating existing and potential deficiencies and irregularities in the water supply. It is also expected to permit us to expand our services to reach universal coverage in these regions, increase the availability of treated water and improve the quality of water available to the population. As of December 31, 2011, R$472.7 million has been invested on this program and we expect to invest R$1.1 billion in the program by 2013. The Mambu/Branco Water Production System is part of this program. It will increase water production to supply municipalities in the south of the Baixada Santista, increasing production from actual 0.6 cubic meter per second to 1.6 cubic meters per second. Additionally, the planned water treatment stations of Jurubatuba, Itú and Cubatão are also part of this program.

New Policies and Programs

Nossa Guarapiranga

In December 2011, we launched the Nossa Guarapiranga project, whose main objective is to recover water quality of the Guarapiranga basin, a water source for the São Paulo metropolitan region. We installed 11 drains to collect residue from rivers in the Guarapiranga basin. We plan to collect an average of 20 cubic meters of residue per day.

Pró-Conexão

In December 2011, the municipality of São Paulo approved a project to offer residences of low-income families subsidized connections to the sewage system. The project involves capital expenditure amounts of up to R$349.5 million, 80% of which would be sustained by the government of the State of São Paulo, while 20% would be paid by us. We believe that this program will increase the efficiency of our sewage collection programs and help improve water quality of the region's rivers and basins, on top of improving the quality of life of low-income families.

We expect that the program will create 192 new thousand connections over the next 8 years and affect approximately 800 thousand people.

Water is Life

In November 2011, we created the program Water is Life which aims to provide sewage services to 41 low-income communities of non-urbanized areas of 20 municipalities in the regions of Alto Paranapanema and Vale do Ribeira. After installing the required infrastructure, an estimated capital expenditure of R$6 million, we will be responsible for maintaining and operating the sewage systems to reach approximately 13 thousand people.

B. Business Overview

Our Operations

As of December 31, 2011, we provided water and sewage services to 363 municipalities in the State of São Paulo either under concession agreements, program agreements, under another form of legal arrangement or under no formal agreement. We also supply treated water on a wholesale basis to six municipalities located in the São Paulo metropolitan region and to the municipality of Sumaré. Pursuant to article 2 of our bylaws, our corporate purpose

includes the provision of water supply and sewage services, urban rain water management and drainage services, urban cleaning services and solid waste management services. In addition, our bylaws authorize us to carry out other related activities, including the planning, operation and maintenance of production systems, the storage, preservation and trading of energy, and the trading of services, products, benefits and rights that, directly or indirectly, result from our assets, projects and activities, and the right to operate a subsidiary anywhere in Brazil or abroad to provide the services mentioned above.

Because of the enactment of the Basic Sanitation Law, which regulates the basic sanitation industry in Brazil, we currently operate under two different contractual environments: (i) for the concession agreements that have already expired, we are currently renegotiating or will negotiate a new agreement that follows the terms and conditions of the Basic Sanitation Law, or program agreements; and (ii) for the concession agreements that have not expired, we will continue to operate under the terms and conditions of the previous concession agreements, except in circumstances where the Basic Sanitation Law is applicable even when the concession agreement is still valid. For further information on this topic, see "Government Regulation—Concessions—Public Consortia and Cooperation Agreement Law for Joint Management."

The Basic Sanitation Law required water and sewage service providers, such as us, to execute a formal agreement by December 31, 2010 with every municipality to which they provide services without a valid legal and binding instrument. If we failed to enter into such formal agreements by December 31, 2010, the concessions would no longer be valid. As of December 31, 2011, 99 of our concessions were still in the process of regularization through the execution of formal agreements. See "3.D. Risks Factors—Risks Relating to Our Business—We cannot anticipate the effects that further developments of the Basic Sanitation Law and its interpretation will have on the basic sanitation industry in Brazil and on us" and "3.D. Risks Factors—Risks Relating to Our Business—We have not entered into formal agreements for the provision of water and sewage services with certain of the municipalities we serve, including municipalities in metropolitan regions, as required by the Basic Sanitation Law, and therefore we may not be able to enforce our rights to continue to provide services in these municipalities."

Concessions

Pursuant to the Brazilian Constitution, the authority to develop public water and sewage systems is shared by the states and municipalities, with the municipalities having primary responsibility for providing water and sewage services to their residents. The Constitution of the State of São Paulo provides that the State shall assure the correct operation, necessary expansion and efficient administration of water and sewage services in the State of São Paulo by a company under its control.

According to the Basic Sanitation Law, existing concessions will remain in effect until payment of indemnification is made based on the valuation of investments. The Basic Sanitation Law provides that our new concession agreements be planned, supervised and regulated by the municipalities together with the State under a new model of associated management that will allow for better control, supervision, transparency and efficiency in the provision of public services.

As of December 31, 2011, we provided water and sewage services to 363 municipalities. Substantially all of these concessions have 30-year terms. Due to court orders, we temporarily suspended our services in five other municipalities (Araçoiaba da Serra, Cajobi, Iperó, Álvares Florence and Macatuba), that as of December 31, 2011 accounted for less than 0.1% of our gross revenues. In January 2011, we resumed the provision of our services to the municipality of Tarumã that had been previously suspended by a court order. For more information, see "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings—Concession-Related Legal Proceedings." Between January 1, 2007 and December 31, 2011, we entered into contracts with 225 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which 25, were entered into in 2011. In addition to the contracts that have 30-year terms, the municipalities entered into cooperation contracts with the State of São Paulo, delegating the regulation and monitoring of the provision of services to the ARSESP. As of December 31, 2011, 99 of our concessions had expired and we have been in negotiation with these municipalities to execute program agreements to substitute the expired concessions. From January 1, 2012 through 2033, 39 concessions will expire. Despite these 99 concessions having expired in 2011, we are renegotiating them and we were continuing to provide water and sewage services to all 99 municipalities as of December 31, 2011. We have entered into an agreement with the State and city of São Paulo for the provision of water and sewage services in the city of São Paulo for a 30-year term expiring in June 2040, which in the year ended December 31, 2011 accounted for 51.4% of our gross revenues from sales and services (including revenues relating to the construction of concession infrastructure).

In February 2006, we created a new division to manage the renewal of expiring concessions. The main responsibility of this division, which reported directly to the Chief Executive Officer, was to renew and thus maintain the existing base of municipalities that we operate and formalize contracts under the new model of associated management. Following the increase in the demand for regulatory work, this division shifted its focus to regulatory matters and its

main roles currently involve centralizing communication with the regulatory agencies, driving business to the new regulatory regime and proposing matters in which we have an interest to the ARSESP.

In April 2011, we created a specific area in our Financial Economic and Investor Relations Office responsible for costs and tariffs, given the subject's importance to the continuation of our business. We also created a statutory Regulatory Affairs Committee. The committee is composed of our Chief Executive Officer, our Chief Financial and Investor Relations Officer, our Metropolitan Officer and our Regional System Officer and is responsible for defining the guidelines, strategies and regulatory recommendations for our Company and coordinating the work of the Regulatory Affairs Department.

The current concessions are based on a standard form of agreement between us and the relevant municipality. Each agreement received the prior approval of the legislative council of each municipality. The assets comprising the existing municipal water and sewage systems are transferred from the municipality to us in order for us to provide the contracted services. Until 1998, we acquired municipal concessions and the existing water and sewage assets in exchange for our common shares issued at book value. Since 1998, we have acquired concessions and water and sewage assets by paying the municipality an amount equal to the present value of 30 years of estimated cash flows, assuming at least 12% certain discount factor to us, from the concession being acquired. For reference purposes, the discount rate adopted in concession contracts was set by the ARSESP in 2011 at 8.6%.

The main provisions of the existing concession agreements are as follows:

- we assume all responsibility for providing water and sewage services in the municipality;
- according to the municipal laws authorizing the concession, we could collect tariffs for our services without prior authorization of the municipality. Tariff readjustments follow the guidelines established by the Basic Sanitation Law and the ARSESP;
- as a general rule, to date, we are exempt from municipal taxes, and no royalty is payable to the municipality with respect to the concession;
- we are granted rights of way on municipal property for the installation of water pipes and mains, and sewage lines; and
- upon termination of the concession, for any reason, we are required to return the assets comprising the municipality's water and sewage system to the municipality and the municipality is required to pay us the non-amortized value of the assets, considered intangible since January 2008, relating to the concession. See Note 2.12 to our financial statements.

Under the concession agreements executed prior to 1998, the reimbursement for the assets may be through payment of either:

- the book value of the assets; or
- the market value of the assets as determined by a third-party appraiser in accordance with the terms of the specific agreement.

Since 1998, contracts that we have entered into with municipalities for the provision of sanitation services have been regulated by the Federal Concessions Law No. 8,987/1995. Generally, these contracts have a 30-year term, and the total value of the concession is set by the discounted cash flow method. Under this method, when the expected contractual cash flow is reached, the total value of the concession and assets is amortized to zero on our books and we receive no payment for the assets. If the concession is terminated prior to the end of the 30-year term, thereby interrupting the normal contractual cash flow, we are paid an amount equal to the present value of the expected cash flow over the years remaining in the concession, adjusted for inflation.

Federal Law No. 11,107, or the Federal Public Consortia and Cooperation Agreement Law, established the legal basis for the administration of public service contracts, giving municipalities responsible for sanitation services greater rights and obligations and setting out more clearly the provision of services and the responsibilities of the parties.

New agreements entered into following the expiry of concession agreements under the previous law will follow this new model. See "—Government Regulation—Concessions—Public Consortia and Cooperation Agreement Law for Joint Management."

Our new agreement model follows the provisions of the Basic Sanitation Law. The main contractual provisions, among others, are joint execution of responsibilities related to planning, supervision and regulation of services and appointment of regulatory authority of services and periodic disclosure of accounts.

Furthermore, the economic and financial formulas in new agreements must be based on the discounted cash flow methodology and on the revaluation of returnable assets. Pursuant to the Basic Sanitation Law, our own preexisting assets will be returnable assets, but we will carry out all new investments and the municipalities will record them as assets. The municipalities will then transfer possession of these assets to us for our use and management and will also record a credit in the same amount of the assets recorded in our favor. According to Article 42 of the Basic Sanitation Law and the new agreement model, investments made during the contractual period are the property of the applicable municipality, which in turn generates receivables for us that are to be recovered through the operation of the services. These receivables may also be used as guarantees in funding operations.

Another important development was that the new agreement model includes exemptions from municipal taxes applicable on our operational areas and the possibility of the revaluation of our assets that existed prior to the execution of the program agreements in cases involving the early resumption of services by the concession authority.

Municipalities have the inherent power under Brazilian law to terminate concessions prior to their contractual expiration dates for reasons of public interest. The municipalities of Diadema and Mauá, two municipalities we previously served, terminated our concessions in February 1995 and December 1995, respectively. The municipality of Mauá terminated our concession with our consent. The municipality of Diadema had terminated our concession without our consent after asserting that we did not provide adequate water and sewage services. In 2011, the municipality of Diadema agreed with us to develop a share infrastructure for the provision of water and sewage services through a mixed-capital company called *Companhia de Água e Esgoto de Diadema*, or CAED. We are not yet able to predict when CAED will begin operations. Despite these developments, we currently serve the municipalities of Diadema and Mauá through the supply of water on a wholesale basis. The indemnities receivables related to the municipality of Mauá totaled R$ 85.9 million are not being recognized in the financial statements due to the uncertainties in the collection. For further information on the lawsuits that arose out of these developments, see "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings."

We currently do not anticipate that other municipalities will seek to terminate concessions due to our close relationship with municipal governments, recent improvements in the water and sewage services we provide, and the obligation of the municipality to repay us for the return of the concession as described above. However, we cannot be certain that other municipalities will not seek to terminate their concessions in the future. See "Item 3.D. Risk Factors—Risks Relating to Our Business—Municipalities may, under certain circumstances, terminate our concessions before their expiration and the indemnification may be inadequate to recover the full value of our investments."

In addition, there is currently ongoing litigation with respect to municipalities that intend to expropriate our water and sewage systems, or to terminate concession agreements before paying us any indemnification. For a detailed discussion on these proceedings, see "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings—Concession-Related Legal Proceedings."

Operations in the City of São Paulo and Certain Metropolitan Regions

As of December 31, 2011, 99 concessions had expired which jointly accounted for 23.8% of our gross revenues. We entered into 25 agreements in the year ended December 31, 2011, bringing the total number of program agreements entered into between 2007 and 2011 to 225. These 25 new agreements accounted for 2.9% of our total revenues and 3.3% of our intangible assets as of December 31, 2011.

The Basic Sanitation Law provides that, in case of termination of the relationship with the aforementioned municipalities, the municipalities should pay us an indemnity, in an amount to be appraised, notwithstanding the non-existence of a concession agreement.

On June 23, 2010, the State and the city of São Paulo entered into a convention with the intermediation and consent of our Company and of the ARSESP pursuant to which they agreed to jointly manage the planning of and investment in the basic sanitation system of the city of São Paulo, among other things. This agreement established that the State and the city of São Paulo would enter into an agreement with us, granting us exclusive rights in the provision of water and sewage services in the city of São Paulo. In addition, the agreement established the role of the ARSESP in regulating and overseeing our activities and established a management committee that will be responsible for planning the water and sewage services and for reviewing our investment plans. The management committee will be composed of six members appointed for two year terms. The State and the city of São Paulo will have the right to appoint three

members each. We are permitted to participate in the meetings of the management committee; however, we are not afforded any voting rights.

On June 23, 2010, we entered into a formal agreement with the State and the city of São Paulo to regulate the provision of water and sewage services in the city of São Paulo for a 30-year period, which may be extended for an additional 30-year period. The Municipal Law No. 14,934/2009 authorized the city of São Paulo to enter into an agreement with us. The agreement establishes, among other things, how specific amounts of gross revenues from the services we render should be allocated (after deduction of COFINS and PASEP). This agreement requires, among other things, (i) to invest at least 13.0% of the gross revenues from sales and services we obtain from the municipality of São Paulo, net of taxes on revenues in the improvement of water and sewage infrastructure in the city of São Paulo; (ii) that our investment plan must be compatible with the activities and programs included in the sanitation plan of the State, the sanitation plan of the city of São Paulo and, if necessary, the sanitation plan of the metropolitan region of São Paulo; and (iii) that we contribute 7.5% of the gross revenues we obtain from this agreement to the São Paulo Municipal Sanitation Fund. The investment plan under this agreement is not irrevocable and will be reviewed by our management committee every four years, especially with regards to investments to be executed in the subsequent period. In addition, the agreement provides that the ARSESP will ensure that the tariffs charged (a) will adequately compensate us for the services we provide and (b) can be adjusted to restore the original balance between each party's obligation and economic gain (*equilíbrio econômico financeiro*). Finally, the agreement envisages the remuneration of the net assets in operation, calculated preferably through asset valuation or by the monetarily updated book value, to be established by the ARSESP. The agreement also foresees the remuneration of the investments to be made by us, such that there will be no residual value at the end of the contract period. We currently have an investment plan in place that consider these obligations and also addresses the compatibility with the activities and programs included in the sanitation plan of the State and of the municipality of São Paulo and, if necessary, the plan of the metropolitan region of São Paulo.

Wholesale Operations

Water Services on a Wholesale Basis

We provide water services on a wholesale basis to six municipalities located in the São Paulo metropolitan region (Diadema, Mauá, Santo André, São Caetano do Sul, Guarulhos and Mogi das Cruzes) and to the municipality of Sumaré. The agreements to provide water services on a wholesale basis must comply with the Basic Sanitation Law, which regulates the stages of the provision of each service, designating them as interdependent activities whose provision requires the supervision of an independent agency, a specific registration for the activities' cost and assurance of payment among the several service providers in order to continue the provision of the services, in accordance with the rules to be published by the ARSESP. Our agreements currently comply with the provisions of the Basic Sanitation Law. In 2011, the revenues from these services were R$203.5 million.

We are currently negotiating with the city of Diadema so as to liquidate the outstanding debts owed by Diadema and Saned to us. For further information on this outstanding debt, see Note 9 to our consolidated financial statements included elsewhere in this annual report.

Sewage Services on a Wholesale Basis

We provide sewage services on a wholesale basis to the municipalities of Mogi das Cruzes, Santo André, São Caetano, Mauá and Diadema. The negotiation of the agreement for the provision of sewage services on a wholesale basis with the municipality of Santo André had the intervention of the Public Prosecution Office, and in other municipalities the negotiation of the agreements was a result of our efforts concerning the environment and the awareness of the municipal public authorities regarding to environmental issues. Through these agreements, in 2011 we treated about 27.2 million cubic meters of sewage from these municipalities. This is an example of our social-environmental responsibility actions and our commitment to these actions. In 2011, the revenues from sewage

services on a wholesale basis were R$21.1 million.

In December 2008, we entered into a five-year agreement for the collection and treatment of 20.0% of the sewage generated by the city of Guarulhos. Due to the complexity of the construction works related to the provision of these services, we have not yet started to provide the sewage services to the city of Guarulhos.

Description of Our Activities

As set forth in Article 2 of our bylaws, our corporate purpose is to render basic sanitation services with the goal of providing basic sanitation services to the entire population in the municipalities where we conduct our activities without harming our long-term financial sustainability. Our activities comprise water supply, sanitary sewage services, urban rainwater management and drainage services, urban cleaning services, solid waste management services and related activities, including the planning, operation, maintenance and commercialization of energy, and the commercialization of services, products, benefits and rights that directly or indirectly arise from our assets, operations and activities. We are allowed to act in a subsidiary form in other Brazilian locations and abroad. See "—Government Regulation—Concessions—Public Consortia and Cooperation Agreement Law for Joint Management."

We set forth below a description of our activities.

Water Operations

Our supply of water to our customers generally involves abstraction of water from various sources, subsequent treatment and distribution to our customers' premises. In 2011, we produced approximately 2,992.0 million cubic meters of water. The São Paulo metropolitan region (including the municipalities to which we supply water on a wholesale basis) currently is, and has historically been, our core market, accounting for approximately 71% of water invoiced by volume in 2011.

The following table sets forth the volume of water that we produced and invoiced for the periods indicated.

	Year ended December 31,		
	2009	**2010**	**2011**
	(in millions of cubic meters)		
Produced:			
São Paulo metropolitan region	2,091.7	2,164.4	2,182.8
Regional systems	753.2	787.9	809.2
Total	**2,844.9**	**2,952.3**	**2,992.0**
Invoiced:			
São Paulo metropolitan region	1,083.9	1,119.2	1,150.6
Wholesale	288.0	293.3	297.3
Regional systems	546.1	579.5	596.8
Reused water	0.8	0.3	0.3
Total	**1,918.8**	**1,992.3**	**2,045.0**

The difference between the volume of water produced and the volume of water invoiced generally represents both physical and non-physical water losses. See "—Water Losses." In addition, we do not invoice:

§ water discharged for periodic maintenance of water mains and water storage tanks;

§ water supplied for municipal uses such as firefighting;

§ water consumed in our own facilities; and

§ estimated water losses associated with water we supply to *favelas* (shantytowns).

Seasonality

Although seasonality does not affect our results in a significant way, in general, higher water demand is observed during the summer and lower water demand during the winter. The summer coincides with the rainy season, while the winter corresponds to the dry season. The demand in the coastal region is increased by tourism, with the greatest demand occurring during the Brazilian summer holiday months.

Water Resources

We can abstract water only to the extent permitted by DAEE pursuant to water usage rights granted by it. Depending on the geographic location of the river basin or if the river crosses more than one state (federal domain), the approval of the National Water Agency (*Agência Nacional de Águas*), or ANA, a federal agency under the Ministry of the Environment is required. We currently abstract substantially all of our water supply from rivers and reservoirs, with a small portion being abstracted from groundwater. Our reservoirs are filled by impounding water from rivers and streams, by diverting the flow from nearby rivers, or by a combination of both methods.

In order to supply water to the São Paulo metropolitan region, we rely on 20 reservoirs of non-treated water and 192 reservoirs of treated water, which are located in the areas under the influence of the eight water producing systems comprising the interconnected water system of the São Paulo metropolitan region. The capacity of the water sources available for treatment in this area is 72 cubic meters per second. Total current installed capacity is 72.7 cubic meters per second, which can be treated from the interconnected water system of the São Paulo metropolitan region. Average verified production during 2011 on the interconnected water system of the São Paulo metropolitan region was 67.9 cubic meters per second. The Cantareira, Guarapiranga and Alto Tietê systems, as a whole, supplied 84.1% of the water we produced for the São Paulo metropolitan region in 2011.

In 2011, the Cantareira system accounted for 46.4% of the water that we supplied to the São Paulo metropolitan region (including the municipalities to which we supplied water on a wholesale basis), which represented 73.9% of our gross revenues from sales and services (excluding revenues relating to the construction of concession infrastructure) for the year. The authorization (*outorga*) for the Cantareira system to use the water in the Piracicaba water basin was renewed on August 6, 2004, for a ten-year period.

Water basin committees are authorized to charge both for water usage and the dumping sewage into water bodies. Since February 2003, we have been incurring expenses in connection with the use of water from the Paraíba do Sul river basin and, since January 2006, from the Piracicaba, Capivari and Jundiaí river basins. At the end of 2010, we started to incur expenses in connection with the use of water from the Sorocaba and Médio Tietê river basins In 2012 we may start to incur expenses in connection with the use of water from the Alto Tietê basin, where the São Paulo metropolitan region is located and from Baixada Santista, Baixo Tietê, Tietê/Jacaré and Tietê/Batalha river basins. The ARSESP has adjusted our tariffs according to the formula that we have used since 2003. According to the formula, "non-controllable" costs, such as costs related to water use, are passed on to our customers through our tariffs. Although we expect to continue to pass on these expenses to our customers through our tariffs, we are uncertain as to whether the river basin committees will change the terms of the charges currently applied and whether we will be able to pass on these costs to our customers. For more information on water usage regulation, see "—Water Usage."

The following table sets forth the water production systems from which we produce water for the São Paulo metropolitan region:

	Production Rate(1)	
	2010	**2011**
Water production system:	*(in cubic meters per second)*	
Cantareira	32.7	31.5
Guarapiranga	13.0	12.6
Alto Tietê	10.9	13.0
Rio Claro	3.9	4.0
Rio Grande (Billings reservoir)	4.8	4.6
Alto Cotia	1.1	1.2
Baixo Cotia	0.8	0.9
Ribeirão da Estiva	0.1	0.1
Total	**67.3**	**67.9**

(1) Average of the twelve months ended December 31, 2010 and 2011.

We own all of the reservoirs in our production systems other than the Guarapiranga and Billings reservoirs and a portion of some of the reservoirs of the Alto Tietê system, which is owned by other companies controlled by the State. We currently do not pay any charges with respect to the use of these reservoirs. In December 2001, we entered into an agreement with the State whereby the State, among other things, agreed to transfer the remaining reservoirs in the Alto Tietê system to us. We accepted, on a temporary basis, the reservoirs in the Alto Tietê System as part of the payment until the State transfers the property rights with respect to the reservoirs to us. We are unable to predict whether and when these reservoirs will be transferred to us because the Public Prosecution Office of the State of São Paulo filed a civil public action alleging that a transfer to us of ownership of the Alto Tietê System reservoirs is illegal. See "Item 3.D. Risk Factors—Risks Relating to Our Control by the State of São Paulo—We may be required to

acquire reservoirs that we use and that are owned by a State-controlled company, or we may be required to pay substantial charges to the owner with respect to our use of these reservoirs."

In January 2009, we began operating, monitoring and maintaining the reservoirs in the Alto Tietê system, formed by the Ponte Nova, Paraitinga, Biritiba, Jundiaí and Taiaçupeba reservoirs. See "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information——Legal Proceedings—Other Legal Proceedings."

In the cities of the countryside region, our principal source of water consists of surface water from nearby rivers and from wells. The coastal region is provided with water principally by surface water from rivers and mountain springs.

Statewide, we estimate that we are able to supply nearly all of the demand for water in all of the areas where we operate, subject to droughts and extraordinary climate events. We were able to meet the demand for water in the São Paulo metropolitan region, primarily as a result of our water conservation program, reductions in water losses, and the installation of new water connections. We installed 201,000, 189,400 and 207,900 new water connections in 2009, 2010 and 2011, respectively.

The interconnected water system of the São Paulo metropolitan region services 30 municipalities, of which 24 are operated directly by us under this system. Through this system, we serve the other six municipalities on a wholesale basis, and the distribution is made by other companies or departments related to each municipality.

In order to reach the final customer, the water is stored and transported through a complex and interconnected system. This water system requires permanent operational supervision, engineering inspection, maintenance, and quality monitoring and measurement control.

To ensure the continued provision of regular water supply in the São Paulo metropolitan region, we intend to invest R$1.3 billion from 2012 to 2015 to increase our water production and distribution capacities as well as to improve the water supply systems. In 2011, our total investment in water supply systems amounted to R$633.2 million.

Water Treatment

We treat all water at our water treatment facilities prior to placing it into our water distribution network. We operate 213 treatment facilities, of which the eight largest, located in the São Paulo metropolitan region, accounts for approximately 70% of all water we produced in 2011. The type of treatment used depends on the nature of the source and quality of the untreated water. Water abstracted from rivers requires extensive treatment, while water drawn from groundwater sources requires less treatment. All water treated by us also receives fluoridation treatment.

Water Distribution

We distribute water through our own networks of water pipes and mains, ranging in size from 2.5 meters to 100 millimeters in diameter. Storage tanks and pumping stations regulate the volume of water flowing through the networks to maintain adequate pressure and continuous water supply. The following table sets forth the total number of kilometers of water pipes and mains and the number of connections in our network as of the dates indicated.

	As of December 31,		
	2009	**2010**	**2011**
Water distribution pipes and mains (in kilometers)	63,732	65,379	66,389
Number of connections (in thousands)	7,118	7,295	7,461

More than 90.0% of the water pipes in our water distribution network are made of cast iron or polyvinylchloride, or PVC. Distribution pipes at customers' residences typically are made from high-density polyethylene tubing. Our water mains are mostly made of steel, cast iron or concrete.

As of December 31 2011, our water distribution pipes and mains included: (i) 33,997 kilometers in the São Paulo metropolitan region; and (ii) 32,392 kilometers in the Regional systems.

As of December 31, 2011, we had 384 storage tanks in the São Paulo metropolitan region with a total capacity of 1.8 million cubic meters, and 1,782 storage tanks in the Regional systems. As of that date, we had 124 treated water pumping stations in the São Paulo metropolitan region aqueduct system, including stations at treatment facilities, intermediate trunk transfer pumping stations and small booster stations serving local areas.

Water mains that require maintenance are cleaned and their lining is replaced. We are typically notified of water main fractures or breaks by the public through a toll-free number maintained by us. We consider the condition of the water

pipes and mains in the São Paulo metropolitan region to be adequate as of the date of this annual report. Due to age, external factors such as traffic, the dense population, and commercial and industrial development, water pipes and mains in the São Paulo metropolitan region are somewhat more susceptible to degradation than those in the Regional systems. To counter these effects, we have a maintenance program in place for water pipes and mains that is intended to address anticipated fractures and clogs due to brittleness and encrustation, and to help ensure water quality in the region. The new customers are responsible for covering the part of the costs of connecting to our water distribution network that are related to the connecting of customers water pipes that are more than 20 meters away from the water mains. Thereafter, the customer must cover the costs of connecting to the network from the customer's premises, including costs of purchasing and installing the water meter and related labor costs. We perform the installation of the water meter and conduct periodical inspections and measurements. After completion of installation, the customer is responsible for the water meter.

The following table sets forth projected new water connections for the periods indicated.

	2012	2013	2014	2015	2016	2017	2018	2019	2012-2019
São Paulo metropolitan region	88	90	88	83	86	84	82	81	682
Regional systems	70	71	72	76	74	75	76	77	588
Total	**158**	**161**	**160**	**156**	**160**	**159**	**158**	**158**	**1,270**

Water Losses

The difference between the amount of water produced and the amount of water invoiced generally represents both physical and non physical water losses. Water loss percentage represents the quotient of (i) the difference between (a) the total amount of water produced by us less (b) the total amount of water invoiced by us to customers minus (c) the volume of water set out below that we exclude from our calculation of water losses, divided by (ii) the total amount of water produced by us. We exclude the following from our calculation of water losses: (i) water discharged for periodic maintenance of water mains and water storage tanks; (ii) water supplied for municipal uses such as firefighting; (iii) water we consume in our facilities; and (iv) estimated water losses associated with water we supply to *favelas* (shantytowns).

Since 2005, we have used a method of measuring our water losses based on worldwide market practice for the industry. According to this measurement method, average water losses are calculated by dividing (i) average annual water loss by (ii) the average number of active water connections multiplied by 366. The result of this calculation is the number of liters of water lost per connection per day.

Using this calculation method, as of December 31, 2011, we experienced 469 liters/connections per day of water losses in the São Paulo metropolitan region and 280 liters/connections per day in the Regional systems, averaging 394 liters/connections per day. We plan to reduce total water losses from 394 liters/connections per day to 211 liters/connection per day between 2011 and 2019. Over the same period, in terms of percentage, we intend to reduce total water losses from 25.6% to 13.0%, however, this goal will be revised based on the results reached so far and the expected reduction with the implementation of the corporate program for water loss reduction in the 2012-2019 period.

Our strategy to reduce water loss has two approaches:

- § reduction in the level of physical losses, which result mainly from leakage, primarily by replacing and repairing water mains and pipes, and installing probing and other equipment, including strategically located pressure-regulating valves; and
- § reduction of non-physical losses, which result primarily from the inaccuracy of our water meters installed at our customers' premises and at our water treatment facilities, and from clandestine and illegal use, by upgrading and replacing inaccurate water meters and expanding our anti-fraud personnel.

We are taking measures to decrease physical losses by reducing response time to fix leakages to less than 24 hours and by better monitoring non visible water mains fractures. Among other initiatives, we have adopted the following measures to reduce physical water losses:

- § the introduction of technically advanced valves to regulate water pressure throughout the water mains in order to maintain the appropriate water pressure to the downstream consumption needs each day. These valves are programmed to respond automatically to variations in demand. During peak usage, the flow of water in the pipes is at its highest point; however, when demand decreases, pressure builds up in the water mains and the resulting stress on the network can cause significant water loss through cracks and an increase in ruptures of the pipes. The technically advanced valves are equipped with probes programmed to feed data to the valve in order to reduce or increase pressure to the water mains as water usage fluctuates. As of December 31, 2011, we had installed 1,783 valves at strategic points in the network, with 1,055 valves being installed in the São Paulo metropolitan region and 728 in the Regional systems;

- § the reconfiguration of interconnected water distribution to permit the distribution of water at lower pressure;

- § the implementation of routine operational leak detection surveys in high water pressure areas to reduce overall water losses;

- § the monitoring of and improved accounting with respect to water connections, especially for large volume customers;

- § regular checking on inactive customers and monitoring non-residential customers that are accounted for as residential customers and, therefore, billed at a lower rate;

- § preventing fraud with the use of new, more sophisticated water meters that are more accurate and less prone to tampering;

- § installing water meters where none are present; and

- § conducting preventive maintenance of existing and newly installed water meters.

Water Quality

We believe that we supply high quality treated water that is consistent with standards set by Brazilian law, which are similar to the standards set in the United States of America and Europe. Pursuant to the Brazilian Ministry of Health (*Ministério da Saúde*) regulations, we have significant statutory obligations regarding the quality of treated water. These laws set certain standards that govern water quality.

In general, the State of São Paulo has excellent water quality from underground or superficial water sources. However, high rates of population growth, increased urbanization and disorganized occupation of some areas of the São Paulo metropolitan region has reduced the quantity and quality of water available to serve the population in the southern area of the São Paulo metropolitan region and in the coastal region. Currently, we successfully treat this water to make it potable. We also work to recover the quality of water of mains and invest in improvements of our treatment systems to ensure the quality and availability of water for the upcoming years.

Water quality is monitored at all stages of the distribution process, including at the water sources, water treatment facilities and on the distribution network. We have 15 regional laboratories, one central laboratory, and laboratories located in all water treatment facilities that monitor water quality, as required by our standards and those set by statute. Our laboratories analyze an average of 50,000 samples per month on distributed water, with samples collected from residences. Our central laboratory located in the city of São Paulo is responsible for organic compound analysis using the chromatographic and spectrometric methods, as well as heavy metals analysis by atomic absorption technique. All of our laboratories have obtained the ABNT NBR ISO 9001 certification and our central laboratory and 11 of our regional laboratories have obtained the ABNT NBR ISO IEC 17025 accreditation (accreditation for general requirements for the competence of testing and calibration laboratories) awarded by the National Institute of Metrology, Standardization and Industrial Quality (*Instituto Nacional de Metrologia, Normalização e Qualidade Industrial*), or the INMETRO.

All chemical products used for water treatment are analyzed and follow strict specifications set out in recommendations made by the National Health Foundation (*Fundação Nacional de Saúde*), or NHF, the Brazilian Association of Technical Rules (*Associação Brasileira de Normas Técnicas*), or the ABNT, and the American Water Works Association, or the AWWA, to eliminate toxic substances that are harmful to human health. From time to time, we face problems with the proliferation of algae, which may cause an unpleasant taste and odor in the water. In

order to mitigate this problem, we work on: (i) fighting algae growth at the water source and (ii) using advanced treatment processes at the water treatment facilities, which involve the use of powdered activated carbon and oxidation by potassium permanganate. The algae growth creates significant additional costs for water treatment because of the higher volumes of chemicals used to treat the water. In 2011, we did not detect significant algae growth.

We participate in the New Life Program which includes a Water Source Program (*Programa Mananciais*), together with other organizations engaged in the promotion of urban development and social inclusion to mitigate the pollution problem in the São Paulo metropolitan region. In addition, we also participate in the Clean Stream Program to clean up important streams in city of São Paulo. Other initiatives also aimed at improving the water quality in our water sources located in the metropolitan region of São Paulo are Guarapiranga and *Pró-Conexão*. See "—Capital Expenditure Program—Main Projects of Our Capital Expenditure Program—Metropolitan System Investment Program—New Life Program and Clean Stream Program."

We believe that there are no material instances where our standards are not being met. However, we cannot be certain that future breaches of these standards will not occur.

Fluoridation

As required by Brazilian law, we have adopted a water fluoridation program designed to assist in the prevention of tooth decay among the population. Fluoridation primarily consists of adding fluorosilicic acid to water at 0.7 parts per million. We add fluoride to the water at our treatment facilities prior to its distribution into the water supply network.

Sewage Operations

We are responsible for the collection and removal of sewage through our sewage systems and for its subsequent disposal with or without prior treatment. As of December 31, 2011, we collected approximately 86% of all the sewage produced in the municipalities in which we operate in the São Paulo metropolitan region. In addition, during the year ended December 31, 2011, we collected approximately 71% of all the sewage produced in the municipalities in which we operate in the Regional systems. During 2011 we accounted for approximately 82% of all the sewage produced in the municipalities in which we operated in the State of São Paulo. We installed 184,900, 233,500 and 246,400 new sewage connections in 2009, 2010 and 2011, respectively.

Sewage System

The purpose of our sewage system is to collect and treat sewage and to adequately dispose of the treated sewage. As of December 31, 2011, we were responsible for the operation and maintenance of 45,073 kilometers of sewage lines, of which approximately 23,645 kilometers are located in the São Paulo metropolitan region and 21,428 kilometers are located in the Regional systems, respectively.

The following table sets forth the total number of kilometers of sewage lines and the total number of sewage connections in our network for the periods indicated.

	As of December 31,		
	2009	**2010**	**2011**
Sewage lines (in kilometers)	42,895	44,287	45,073
Sewage connections (in thousands)	5,520	5,718	5,921

Our sewage system comprises a number of systems built at different times and constructed primarily from clay pipes and, more recently, PVC tubing. Sewage lines larger than 0.5 meters in diameter are primarily made of concrete. Our sewage system is generally designed to operate by gravitational flow, although pumping stations are required in certain parts of the system to ensure the continuous flow of sewage. Where pumping stations are required, we use sewage lines made of cast iron.

The public sewage system operated by us was structured in order to receive industrial sewage and sewage from non-domestic sources for treatment together with domestic sewage. Industrial sewage has physical, chemical and/or biological characteristics that are qualitatively different from household effluents. As a result, the discharge of industrial sewage into the public sewage system is subject to compliance with specific legal demands with the purpose to protect the sewage collection and treatment systems, the health of operators and the environment. The current environmental legislation establishes standards for the discharge of these effluents into the public sewage system. These standards are defined in Article 19A of State Decree No. 8,468 dated September 8, 1976. To ensure compliance with legislation, periodic audits of the sewage produced by all industrial clients are conducted, and we

also request self-monitoring reports from non-domestic sewage-producing sources.

The discharge of these effluents into the public sewage system is based on technical and administrative procedures. Before the discharge is permitted, we carry out acceptance studies that assess the capacity of the public sewage system to receive the discharge as well as the compliance with regulations. Upon the conclusion of these studies, the technical and commercial conditions for receiving the discharge are established, which are then formalized in a document signed by us and the effluent producer. Failure to comply with these conditions can lead to the application of penalties and the obligation of the effluent producer to conduct the necessary adjustments in a given time frame. Non-compliance with these penalties and adjustments may ultimately result in the suspension of the connection and notification of the environmental protection agency (*Companhia Ambiental do Estado de São Paulo*), or the CETESB, in order for the applicable measures to be taken. Effluents from our treatment facilities must comply with effluent limitation guidelines and observe the water quality of the receiving water bodies established by federal and state legislation. Effluent limitation guidelines consist of a set of parameters that must be verified before the effluents are discharged into a water body. Water quality standards are based on the classification of water bodies, and take into account the current or expected use of water. These standards will become more rigorous according to the importance of the use of water.

We considered the condition of the sewage lines in the São Paulo metropolitan region to be adequate as of the date of this annual report. Due to greater volume of sewage collected, a higher population and more extensive commercial and industrial development, the sewage lines in the São Paulo metropolitan region are more deteriorated than those of the Regional systems. To counter the effects of deterioration, we maintain an ongoing program for the maintenance of sewage lines intended to address anticipated fractures arising from obstructions caused by system overloads.

Unlike the São Paulo metropolitan region, the countryside region does not generally suffer obstructions caused by sewage system overload. The coastal region, however, experiences obstructions in its sewage lines primarily due to infiltration of sand, especially during the rainy season in the summer months. In addition, the sewage coverage ratio in the coastal region is significantly lower than in the other regions served by us, with approximately 99% of all residences in the coastal region currently connected to our sewage network as of December 31, 2011.

New sewage connections are made on substantially the same basis as connections to water lines: we assume the cost of installation for the first 20 meters of sewage lines from the sewage network to all customers' sewage connections and the customer is responsible for the remaining costs.

The following table sets forth projected new sewage connections for the periods indicated.

	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2012-2019**
São Paulo metropolitan region	99	102	117	126	145	144	148	81	962
Regional systems	106	105	114	101	104	118	118	113	879
Total	**205**	**207**	**231**	**227**	**249**	**262**	**266**	**194**	**1,841**

Sewage Treatment and Disposal

In 2011, approximately 86% and 75% of the sewage we collected in the São Paulo metropolitan region and the Regional systems, respectively, or 82% of the sewage we collected in the State of São Paulo, was treated at our treatment facilities and afterwards discharged into receiving water bodies such as inland waters and the Atlantic Ocean, in accordance with applicable legislation. Our sewage treatment facilities have a limited capacity. Flows in excess of this capacity are discharged directly, untreated, to inland waters and the Atlantic Ocean. We currently operate 481 sewage treatment facilities and nine ocean outfalls.

We operate 490 activated sewage treatment facilities, of which the five largest, located in the São Paulo metropolitan region, have treatment capacity of approximately 18 cubic meters of sewage per second.

Sewage treatment in the Regional systems will vary according to the particularities of each area. In the countryside region, treatment consists largely of stabilization ponds where the organic matter is treated and discharged to receiving waters. There are 392 secondary treatment facilities in the countryside region that have treatment capacity of approximately 13.0 cubic meters of sewage per second.

The majority of sewage collected in the coastal region receives treatment and disinfection and is then discharged into rivers and into the Atlantic Ocean through our ocean outfalls. We have 75 sewage treatment facilities in the coastal region.

Our sewage collection system is currently not sufficiently extensive to transport all sewage collected by us to our treatment facilities. As a result, a portion of the sewage collected by us is discharged untreated into receiving waters. We are a party to a number of legal proceedings related to environmental matters. See "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings." In addition, our capital expenditure program includes projects to increase the amount of sewage that we treat. See "Item 4.A. History and Development of the Company—Capital Expenditure Program" and "4.B Business Overview—Government Regulation—Environmental Regulation—Sewage Requirements."

Sludge Disposal

In the São Paulo metropolitan region, the treatment process used by most treatment facilities is the activated sludge process, where there is a liquid phase and a solid phase which generates sludge. The activated sludge process was developed in England in 1914. It is widely used for the treatment of household and industrial sewage. The work consists of a system in which a biological mass grows, forms flakes, is continually re-circulated and put in contact with organic matter, always with the presence of oxygen (aerobic). The activated sludge process is strictly biological and aerobic, in which the raw sewage and the activated sludge are mixed, agitated and aerated in units known as secondary decanters where the solid part is separated from the treated wastewater. The settled sludge returns to the aeration tank or is removed for specific treatment.

Sludge removed from the primary and secondary treatment processes typically contains water and a very small proportion of solids. We use filter presses, belt presses and centrifugation machines to abstract the water from the sludge. In 2011, we produced 46,450 tons of sludge-dry base, of which 45,595 tons were discharged into landfills. The remaining portion of the sludge-dry base was used as fertilizer in forest and agriculture projects, fuel development and concrete manufacturing.

Sludge disposal must comply with State and Federal law requirements, such as Resolution No. 375 of August 29, 2006 of the CONAMA, Federal Law No. 12,305/2010, Federal Decree No. 7,404/2010, State Law No. 12,300/2006 and State Decree No. 54,645/2009.

Principal Markets in Which We Operate

As of December 31, 2011, we operated water and sewage systems in 363 of the 645 municipalities in the State of São Paulo. In addition, we currently supply water on a wholesale basis to six municipalities located in the São Paulo metropolitan region and the municipality of Sumaré with an urban population of approximately 3.7 million.

The following table provides a breakdown of gross revenues from water supply and sewage services by geographic market for the periods indicated.

	Year ended December 31,		
	2009	**2010**	**2011**
	(in millions of R$)		
São Paulo metropolitan region	5,280.8	5,699.6	6,144.7
Regional systems	1,764.6	1,956.3	2,165.4
Total	**7,045.4**	**7,655.9**	**8,310.1**

The following table provides a breakdown of gross revenues from water supply and sewage services by category of activity for the periods indicated.

	Year ended December 31,		
	2009	**2010**	**2011**
	(in millions of R$)		
Water supply	4,104.3	4,427.4	4,610.2
Sewage services	3,131.9	3,398.7	3,699.9
Adjustment to IFRS – revenue recognition (wholesale)	(190.8)	(170.2)	-
Total	**7,045.4**	**7,655.9**	**8,310.1**

Competition

We believe there are at least two reasons behind a possible increase in our participation in the domestic sanitation market. In the State of São Paulo, there are approximately 274 municipalities that operate their own water and sewage systems and that collectively have a population of approximately 13 million, or approximately 33% of the population

of the State of São Paulo, excluding the population of the municipalities to which we provide water services on a wholesale basis. Given our scale, we are well positioned to capture opportunities in these municipalities. In comparison to the companies providing water and sewage services outside the State of São Paulo, we believe we have technological advantages compared to other water and sewage services providers, which should result in our competitively advantageous position in regions outside the State of São Paulo.

The competition for municipal concessions arise mainly from the municipalities, as they may resume the water and sewage services that were granted to us and start providing these services directly to the local population. In this case, the municipal governments would be required to indemnify us for the unamortized portion of our investment. See "—Business Overview—Our Operations—Concessions." In the past, municipal governments have terminated our concessions agreements before the expiration date. Furthermore, municipal governments have tried to expropriate our assets in an attempt to resume the provision of water and sewage services to local populations. See "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings." We negotiate expired concession agreements and concession agreements to be expired with the municipalities in an attempt to maintain our existing areas of operations. In the State of São Paulo we face competition from private and municipal water and sewage service providers.

In recent years, we have also experienced an increasing level of competition in the market of water supply to large customers. Several large industrial customers located in municipalities served by us use their own wells to supply themselves with water. In addition, competition for the disposal of non-residential, commercial and industrial sludge in the São Paulo metropolitan region has increased in recent years as private companies offer stand-alone solutions inside the facilities of their customers. We have also established new tariff schedules for commercial and industrial customers in order to assist us in retaining these customers. For this group of customers, we have a special authorization from ARSESP to establish different tariff than the ones that agency establishes for regular consumers.

Billing Procedures

The procedure for billing and payment of our water and sewage services is basically the same for all customer categories. Water and sewage bills are based upon water usage determined by monthly water meter readings. Larger customers, however, have their meters read every 15 days to avoid non-physical losses resulting from faulty water meters. Sewage billing is included as part of the water bill and is based on the water meter reading.

The most part of the bills for water and sewage services are delivered to our customers in person, mainly through one of our employees or through independent contractors who are also responsible for reading water meters. The remainder, by judicial determination, is sent by mail. Water and sewage bills can be paid at some banks and other locations in the State of São Paulo. These funds are paid over to us after deducting average banking fees ranging from R$0.29 to R$1.15 per transaction for collection and remittance of these payments.

Customers must pay their water and sewage bills by the due date if they wish to avoid paying a fine. We generally charge a penalty fee and interest on late bill payments. In 2009, 2010 and 2011, we received payment of 94.7%, 95.5% and 94.8%, respectively, of the amount billed to our retail customers, and 93.9%, 95.5% and 94.7%, respectively, of the amount billed to those customers other than State entities, within 30 days after the due date. In 2009, 2010 and 2011, we received 110.1%, 97.1% and 96.0%, respectively, of the amount billed to the State entities. Amounts in excess of 100.0% reflect our recovery of amounts billed in prior years. With respect to wholesale supply, in 2009, 2010 and 2011, we received payment of 68.7%, 58.3% and 54.7%, respectively, of the amount billed within 30 days.

We monitor water meter readings by use of hand-held computers and transmitters. The system allows the meter reader to input the gauge levels on the meters into the computer and automatically print the bill for the customer. The hand-held computer tracks water consumption usage at each metered location and prepares bills based on actual meter readings. Part of the water meter monitoring for billing purposes is carried out by our own personnel, trained and supervised by us and part of it is carried out by third-party contractors that employ and train their own personnel whose training we supervise.

Tariffs

Tariff adjustments follow the guidelines established by the Basic Sanitation Law and the ARSESP. The guidelines also establish procedural steps and the terms for the annual adjustments. The adjustments have to be announced 30 days prior to the effective date of the new tariffs which occur in September, and last for a period of at least 12 months.

Tariffs have historically been adjusted once a year and for periods of at least 12 months. We increased our tariffs for water and sewage services by 6.8%, 9.0% and 6.7% in August 2004, 2005 and 2006, respectively. On September 2007, tariffs rose by 4.12%, except for water supply and sewage collection tariffs for consumption of more than 20 cubic meters in non-residential categories, which were adjusted by the cumulative inflation from August 2006

to July 2007 in the consumer price index (*Índice Nacional de Preços ao Consumidor Amplo*), or IPCA, index published by IBGE, which came to 3.74%.

See "—Government Regulation—Tariff Regulation in the State of São Paulo" for additional information regarding our tariffs.

With the publication of the Basic Sanitation Law, the regulation of basic sanitation services, including tariff regulation, became the responsibility of an independent regulator. To exercise this assignment, the State of São Paulo created the ARSESP, which regulates and supervises the services we provide to the State and also within the municipalities that have agreed to its jurisdiction through a cooperation agreement entered into by that municipality.

In regards to municipalities that have not explicitly selected the ARSESP as their regulator, the Basic Sanitation Law admits the possibility of that municipality creating other regulatory agencies of their own. In 2007, the municipality of Lins decided to create its own regulatory authority, although having revised this decision in 2010, transferring to ARSESP the regulation of the water activities performed in Lins, including for the setting of tariffs. The municipality of Lins has reserved, however, the power to ultimately approve the tariff set by the ARSESP. In 2011, the municipalities in which the hydrographic basins of the rivers Piracicaba, Capivari and Jundiaí are located have created a consortium for regulation and supervision of our activities in that area. See " Government Regulation—Tariff Regulation in the State of São Paulo " for additional information.

As of the date of this annual report, the ARSESP applied the adjustment formula for our tariffs that we established on August 29, 2003. This adjustment was developed to better reflect changes in our cost structure. According to this formula, the cost components of the Tariffs Adjustment Index, or IRT, are separated into two parts ("Part A" and "Part B"), where "Part A" encompasses all costs related to energy, water and sewage treatment materials; federal, state and local taxes; and financial compensation due to use of water resources. "Part B" encompasses all other costs and expenses. "Part B" relates to the difference between the gross operating revenue and the value of "Part A" for the same period. The adjustment of "Part A" is based on the effective cost variation observed in its components during the preceding 12-month period. "Part B" is adjusted by the IPCA index. The adjustment to the formula used by the ARSESP replaced the variable gross operating revenue for the variable cost of reference.

In September 2008, we adjusted our tariffs by 5.10% pursuant to the ARSESP's authorization. In August 2009, the ARSESP approved a 4.43% adjustment for our water and sewage tariffs, starting on September 11, 2009. In August 2010, the ARSESP approved a 4.05% adjustment for our water and sewage tariffs, starting on September 11, 2010. In 2011, we readjusted our prices in 6.83%, starting on September 11, 2011. This adjustment was valid for all municipalities served by us, except for the municipalities of São Bernardo do Campo, Lins and Magda, which have different rules and readjustment dates. The tariffs in the municipality of São Bernardo do Campo are adjusted pursuant a different methodology due to the difference between the tariffs charged in that municipality when we assumed the service and the tariffs we were charging in other metropolitan municipalities we serve. The adjustments in São Bernardo do Campo are set so that in September 2012 the tariff charged in this municipality and the tariff charged in the other municipalities of the region will be the same. With respect to the municipality of Lins, our tariff is adjusted in January according to the variation of the IPCA for the last twelve-month period ended November 30. In regards to Magda, adjustments are expected to be made by 2015.

Until the new tariff structure we propose is approved by the ARSESP, we will continue to use our current tariff structure. As such, we currently divide tariffs into two categories: residential and non-residential. The residential category is subdivided into standard residential, residential social and *favela* (shantytowns). The residential social tariffs apply to residences of low-income families, residences of persons unemployed for up to 12 months and collective living residences. The *favela* tariffs apply to residences in shantytowns characterized by a lack of urban infrastructure. The latter two sub-categories were instituted to assist lower-income customers by providing lower tariffs for consumption. The non-residential category consists of: (i) commercial, industrial and public customers; (ii) "not-for-profit" entities that pay 50.0% of the prevailing non-residential tariff; (iii) government entities that have entered into a water loss reduction agreement with us and pay 75.0% of the prevailing non-residential tariff; and (iv) public entities that have entered into program agreements, for municipalities with a population of up to 30,000 and with half or more classified according to their degree of social vulnerability by the Social Vulnerability Index of São Paulo (*Índice Paulista de Vulnerabilidade Social*), or IPVS, 5 and 6, of the SEADE, obtained through the analysis of the 2000 Census figures, and start to receive tariff benefits, in accordance with our normative ruling, for the category of public use, at the municipality level. The tariffs are equal to those offered to the commercial/entity of social assistance and that corresponds to 50.0% of the public tariffs without contractual provisions referred to in item (iv) above.

We established a new tariff schedule, effective May 2002, for commercial and industrial customers that consume at least 5,000 cubic meters of water per month and that enter into fixed demand agreements (take-or-pay) with us for at least one-year terms. In October 2007, the minimum volume for entering into these agreements was reduced from 5,000 cubic meters per month to 3,000 cubic meters per month. We believe this tariff schedule will help prevent our commercial and industrial customers from switching to the use of private wells. Since 2008, we have been authorized by the ARSESP to establish tariffs for non-residential customers, such as industrial and commercial customers, that consume more than 3,000 cubic meters per month, with a maximum tariff equal to the tariffs applicable to non-residential customers that consume more than 50 cubic meters per month. In 2010, the ARSESP authorized a reduction in the minimum volume of consumption for customers that enter into demand agreements with us to a minimum of 500 cubic meters per month.

We establish separate tariff schedules for our services in each of the São Paulo metropolitan regions and each of the countryside and coastal regions which comprise our Regional systems. Each tariff schedule incorporates regional cross-subsidies, taking into account the customers' type and volume of consumption. Tariffs paid by customers with high monthly water consumption rates exceed our costs of providing water service. We use the excess tariff billed to high-volume customers to compensate for the lower tariffs paid by low-volume customers. Similarly, tariffs for non-residential customers are established at levels that subsidize residential customers. In addition, the tariffs for the São Paulo metropolitan region generally are higher than tariffs in the countryside and coastal regions.

Sewage charges in each region are fixed and are based on the same volume of water charged. In the São Paulo metropolitan region and the coastal region, the sewage tariffs equal the water tariffs. In the countryside region, sewage tariffs are approximately 20.0% lower than water tariffs. Wholesale water rates are the same for all municipalities served. We also make available sewage treatment services to those municipalities in line with the applicable contracts and tariffs. In addition, various industrial customers pay an additional sewage charge, depending on the characteristics of the sewage they produce.

Each category and class of customer pays tariffs according to the volume of water consumed. The tariff paid by a certain category and class of customer increases progressively according to the increase in the volume of water consumed. The following table sets forth the water and sewage services tariffs by (i) customer category and class and (ii) volume of water consumed charged during the years and period stated in the São Paulo metropolitan region.

	As of December 31,		
Customer Category Consumption	**2009[2]**	**2010[3]**	**2011[4]**
Residential			
Standard Residential:			
0-10[1]	1.36	1.42	1.52
11-20	2.13	1.22	2.37
21-50	5.32	5.54	5.92
Above 50	5.86	6.10	6.52
Social:			
0-10[1]	0.46	0.48	0.51
11-20	0.80	0.83	0.89
21-30	2.82	2.93	3.13
31-50	4.03	4.19	4.48
Above 50	4.45	4.63	4.95
Favela (shantytown):			
0-10[1]	0.35	0.37	0.39
11-20	0.40	0.42	0.45
21-30	1.33	1.38	1.47
31-50	4.03	4.19	4.48
Above 50	4.45	4.63	4.95
Non Residential			
Commercial/Industrial/Governmental:			
0-10[1]	2.74	2.85	3.04
11-20	5.32	5.54	5.92
21-50	10.21	10.62	11.35

Above 50	10.63	11.06	11.82
Social Welfare Entities:			
0-10[(1)]	1.37	1.42	1.52
11-20	2.67	2.78	2.97
21-50	5.13	5.34	5.70
Above 50	5.31	5.53	5.91
Government entities that employ the Rational Use of the Water Program (*Programa de Uso Racional da Água*), or PURA, with reduction agreement:			
0-10[(1)]	2.05	2.14	2.28
11-20	3.99	4.15	4.43
21-50	7.67	7.98	8.53
Above 50	7.97	8.29	8.86

(1) The minimum volume charged is for ten cubic meters per month.

(2) From September 11, 2009 to September 10, 2010.

(3) From September 11, 2010 to September 10, 2011.

(4) Since September 11, 2011.

Both in 2010 and 2011, the average tariff calculated for the Regional systems was approximately 30% below the average tariff of the São Paulo metropolitan region.

Regarding the new tariff structure that ARSESP aims to implement, since 2008 it has been developing new concepts that might be included in the tariff structure and adjustment formula but it has so far regulated our tariff structure and adjustments according to the same structure and adjustment formula that we ordinarily follow.

On July 22, 2009, the ARSESP released a Technical Note (*Nota Técnica*) regarding the methodology for the tariff adjustment process and submitted it for public comments. On August 12, 2009, the ARSESP informed that the new methodology would not be applied for the 2009 adjustment. The ARSESP is currently working on the development and improvement of its new methodology and it expects to release a revised tariff structure and adjustments formula in 2012.

In March 2011, the ARSESP published the tariff review schedule and opened a public hearing for the proposed methodology for the calculation of the weighted average cost of capital (WACC). In May 2011, the ARSESP released a regulatory post-tax weighted average cost of capital of 8.06%. In October 2011, we presented to the ARSESP a detailed business plan that disclosed requested information regarding our income, expenses and capital expenditures, so that the ARSESP could set an adjustment formula for our tariffs. In January 2012, the ARSESP commenced a public consultation regarding our methodology for tariff revisions. The public consultation aims to: (i) set the initial framework for periodic tariff revisions for all municipalities we serve that are under the supervision of the ARSESP; (ii) discuss the criteria adopted to determine the cost of services, the tariff framework and the subsidies policy, among other issues; (iii) create a methodology, standards and procedures for future revisions and adjustments; and (iv) ensure the broad involvement of municipalities, concessionaires, consumers, investors and others.

In 2010, the ARSESP defined the rules to evaluate our asset base (Rule No. 156/2010). By August We have hired companies to conduct such an evaluation using this methodology and by August 2012, we will present to the ARSESP the evaluation of our asset base according to reposition cost and weighted by the respective usage ratio in accordance with ARSESP Rule No. 156/2010, on which our regulatory remuneration will be based. We will also present ARSESP with a detailed business plan that will serve as a basis for the final tariff methodology process to be released by the ARSESP in the near future. In September 2012, we expect to receive the ARSESP's preliminary average tariff proposal and the applicable efficiency gains factor that we will be required to include in the tariff structure proposal that the ARSESP will then request from us. By October 2012, we expect to be able to propose such tariff structure, and our preliminary average tariff, efficiency gains factor and tariff structure will then be submitted for public hearing. The ARSESP estimates that a final public hearing at which our preliminary average tariff, efficiency gains factor and tariff structure will be subjected to public scrutiny will be scheduled by November 2012. The aforementioned schedule may, however, suffer alterations or be subject to delays.

Marketing Channels

As of December 31, 2011, we were the concessionaire for the provision of water supply and collection, treatment and disposal of sewage services directly to end consumers for 363 municipalities of the State of São Paulo. We also supply water on a wholesale basis to six municipalities located in the São Paulo metropolitan region and the municipality of Sumaré. It is the responsibility of these municipalities to then distribute the water to end consumers. We provide sewage services to five of these municipalities. Because of our distribution infrastructure, end consumers to whom we offer water services on a wholesale basis cannot alternatively acquire such services directly from us. For more information on service concessions, see "4.B. Business Overview—Wholesale Operations."

Energy Consumption

Energy is essential to our operations, and as a result we are one of the largest users of energy in the State of São Paulo. In the year ended December 31, 2011, we used 1.76% of the total energy consumption in the State of São Paulo. To date, we have not experienced any major disruptions in energy supply. Any significant disruption of energy to us could have a material adverse effect on our business, financial condition, results of operations or prospects. See "Item 3.D. Risk Factors—Risks Relating to Our Business—We are exposed to risks associated with the provision of water and sewage services."

Energy prices have a significant impact on our results of operations. An average increase in energy prices of 17.6% in 2003 negatively affected our results of operations in 2004. In 2011, 44% of our total energy consumption occurred within the "free market", where we can more efficiently negotiate the supply of energy. This energy was provided by Companhia Energética São Paulo, or CESP, pursuant to a long-term contract expiring in October 2012. AES Tiête (39%) and Tractebel Energia S.A. (61%) have already been hired to provide these services for the remainder of 2012 and until 2015.

Insurance

We maintain insurance covering, among other things, fire or other damage to our property, office buildings and third-party liability. We also maintain insurance coverage for directors' and officers' liability (D&O insurance). We currently obtain our insurance policies by means of public bids involving major Brazilian and international insurance companies that operate in Brazil. As of December 31, 2011, we had paid a total aggregate amount of R$9.3 million in premiums, covering R$2.1 million on assets, third-party liabilities and D&O insurance. We do not have insurance coverage for business interruption risk because we do not believe that the high premiums for such insurance are justified by the low risk of major interruption of our activities. In addition, we do not have insurance coverage for liabilities arising from water contamination or other problems involving our water supply to customers and for environmental related liabilities and damages. We believe that we maintain insurance at levels customary in Brazil for our type of business.

Environmental Matters

Our environmental policy, which we revised in January 2008, established environmental management directives that allow us to become a contributing force to environmental sustainability and excellence. These directives are based on a systematic approach to the environment, which allow us to develop a plan that integrated economic, environmental and social dimensions of our work with sustainable use of natural resources.

In order to coordinate the environmental demands with the specific needs of the different places we operate, we have implemented 20 Environmental Management Centers (*Núcleos de Gestão Ambiental*), or NGAs. The NGAs are closely involved in operational matters, providing decision-making support at a local level and seeking to ensure that environmental guidelines are respected throughout our organization. In this manner, they help contribute to the ongoing improvement of our environmental performance.

We have the following environmental management programs:

- execution of a Environmental Management System, or EMS, and acquisition of ISO 14001 certification to our sewage and water treatment facilities. We received the certifications for 50 sewage treatment facilities, including those located in the São Paulo metropolitan, countryside and coastal regions. 65 of our water treatment facilities and sewage treatment facilities have implemented the EMS, and we expect to extend it progressively to our remaining installations;

- participation in the Carbon Disclosure Project (CDP) and adherence to the Carbon Disclosure Project CDP Supply Chain;

- conception and formation of the Corporate Management of Greenhouse Gas Program (*Programa Corporativo de Gestão de Emissões de Gases de Efeito Estufa*);

- the monitoring and controlling compliance with conduct adjustment terms and judicial agreements relating to the environment;

-

formation and implementation of a corporate program for maintenance and regularization of environmental licenses and of granting water usage rights;

- § the implementation of the Environmental Education Program (*PEA SABESP*), including over one hundred environmental education actions and projects involving the community and other stakeholders ;

- § our institutional representation in the State and National Systems of Water Resources Management, including training of company representatives to participate in councils of the National and State Systems for the Management of Water Resources (*Sistemas Nacional e Estadual de Gerenciamento de Recursos Hídricos*), training of the representatives for participation in the process of establishing criteria for the charging of water usage, monitoring of water basin plans (*Planos das Bacias*), water bodies classification programs and the establishment or review of specific legislation on the matter;

- § the structuring of educational activities related to analyzing, managing, and communicating environmental risks;

- implementation of the SABESP 3-Rs Program (*Programa SABESP 3Rs*) for the reduction, re-use and recycling of waste of administrative activities, a program involving the two largest administrative areas of our Company with plans to include all other administrative areas.

In addition to corporate environmental *management initiatives*, since 2008 we launched several projects to benefit the environment by engaging the community and third parties with non-governmental organizations, including:

- Oil Recycling Program (*Programa de Reciclagem de Óleo de Fritura*), or PROL;
- One million Trees in Cantareira (*Programa "Um Milhão de Árvores no Cantareira"*);
- Green Hug (*Abraço Verde*);
- Community Gardens (*Hortas Comunitárias*);
- Program of Lectures on Environmental Management (*Ciclos de Conferências de Gestão Ambiental*);
- Supporters of Sustainability (*Audiências de Sustentabilidade*);
- 'Nossa Guarapiranga' Project (*Programa Nossa Guarapiranga*);
- Water park in Campos do Jordão (*Parque Lagoinha*);
- Environmental Support Actions (*ecomobilizações);*
- First Green Building (*Primeiro Predio Verde Certificado);*
- Recycling programs;
- Radio Program 'My Environment' (*Meu Ambiente*);
- Partnership with Abrafati in the a project for the cleaning of green areas (*Pintou Limpeza);*
- Green Post (*Ecoposto Sabesp*);
- Maintaining of environmentally protected areas;
- Green Life Program (*Programa Verde Vida*);
- Plant a Tree, a Child Is Born (*Nasce uma Criança Plante uma Árvore*);
- Sustainable purchasing policy;
- Reuse of scrap material from construction;
- Support and sponsoring to environmentally important projects and initiatives;

§ Cyan Bank (*Banco Cyan*) program for the reduction of water consumption.

Climate Change Regulations: Reduction of Greenhouse Gases (GHG)

We are required to comply with laws and regulations related to climate change, including international agreements and treaties to which Brazil is a signatory.

The São Paulo State Climate Change Policy (Law No. 13,798), enacted on November 9, 2009, seeks to reduce global emissions of carbon dioxide by 20.0% by 2020 compared with 2005 levels. Brazil's Climate Change Policy (Law No. 12,187), enacted on December 29, 2009, establishes a voluntary national commitment to reduce Brazil's currently projected GHG emissions for 2020 by a percentage between 36.1% and 38.9%. If legislation requires us to reduce our emissions, we may do so by transforming biogas from the treatment of sewage into energy, for example, which may lead to potential economic gains.

We have begun significant initiatives, such as the corporate program for water loss reduction and the implementation of small hydroelectric power plants, to reduce GHG emissions during the coming years. We recently launched the Aquapolo project, the fifth largest project in the world to use reclaimed water production for industrial purposes, which uses treated sewage as input. This project, capable of producing 1,000 liters per second (Ps) of reclaimed water, will increase the supply of treated water for the São Paulo metropolitan region and may potentially reduce GHG emissions. Our investments in the Aquapolo project amounted to approximately R$252 million. We created our inventory of GHG emissions for the year 2008 and are verifying our inventories for the years 2009 and 2010. Moreover, we are developing a management program for GHG emissions. The program includes studies of impacts and risks related to climate change and the study of potential scenarios based on our emissions of GHG.

At this point, it is still not possible to predict if climate change policies will provide opportunities or generate new costs for us. Reducing our emissions of carbon dioxide will involve costs and expenses in implementing more stringent control mechanisms, adopting pollution prevention measures and actions to minimize the generation of GHGs. We may not receive financial incentives to offset all or part of these costs. In addition, if limitations in GHG emissions affect our supply chain and increase our costs, we may not be able to pass on these costs to our end consumers. See "4.B. Business Overview—Tariffs."

Regulation of GHG emissions could also benefit us in the short term, since we may be able to obtain subsidies, financial investments and tax incentives for projects to protect and restore water sources, conserve water, treat sewage, conserve energy, increase energy efficiency, and promote self-generated energy, among other projects that seek to reduce the impact of climate change.

Carbon Disclosure Project

§ *Carbon Disclosure Project Investors*. We participate in the Carbon Disclosure Project – CDP, a global initiative focused on the financial risks related to climate change. Through this project, main international institutional investors ask the world's largest companies to demonstrate that they are managing carbon effectively. We have received and responded the project's questionnaires since 2006. The companies that opt to have their answers disclosed to the public, such as our case, have their answers published in an international website of public interest. The questionnaire asks mainly questions related to the aspects of climate change and corporate governance, the physical, financial and regulatory effects of climate change, and opportunities that affect or could positively or negatively affect us.

§ *Carbon Disclosure Project Supply Chain.* On December 2010, we adhered to the Carbon Disclosure Project – CDP Supply Chain 2011. The project seeks to encourage the adoption of a standard methodology by our main suppliers of goods and services to measure risks related to climate change and GHG emissions. We have invited 97 of our main suppliers of goods and services to join the CDP Supply Chain, from which 20% have joined the project.

Physical Effects of Climate Change

Since our financial performance is closely linked to climate patterns that influence in the availability of water (in terms of quantity and quality of water resources), extreme weather conditions may adversely affect our business and operations. If long-term climate change causes significant alterations in environmental conditions, such as an increase in the frequency of extreme weather conditions, this could affect the quality and quantity of water available for abstraction, treatment and supply, affecting the costs of services and tariffs.

An increase in heavy rainfall can impact water quality and the regular operation of water sources, including abstraction of water from our dams, through increased soil erosion, silting, pollution and eutrophication of aquatic ecosystems. In addition, increased flows of rainwater into sewage systems may overwhelm the capacity of sewage treatment plants. We may need to build larger reservoirs, since it is not feasible to increase the size of our existing reservoirs, or increase operational capacity by further automating our existing equipment. To increase automation, we would need to purchase and operate tools to measure dam levels and volumes, river output and the rain in hydrographic basins, create mathematical models for real time operations, and train technicians to operate these systems. As an alternative, we may need to implement new production systems.

In the case of prolonged periods of drought, for example, reduced water levels in dams can cause an increase in the concentration of plant matter by increasing eutrophication and, consequently, increasing water treatment costs and operational complexity. In addition, prolonged periods of drought in watersheds such as the São Paulo metropolitan

region, where most of our production is concentrated, may result in the growth of vegetation in the reservoir flooding areas, which can impact water quality due to the accumulation of organic matter. In such cases our production costs may increase, affecting our financial margins and the quality of water we produce. Droughts also lower reservoir levels available for hydroelectric plants, which may lead to power shortages, particularly since hydroelectric power accounts for most of Brazil's electric energy supply. A lack of rainwater could lead to instability in domestic water supplies and in sewage collection and treatment services, which could damage our reputation. In addition, because we are one of the largest consumers of electricity in the State of São Paulo, a potential increase in electricity tariffs due to a shortage of hydroelectric power could have a significant economic impact on us.

We are also the concessionaire for water and sewage services for all the coastal municipalities of the State of São Paulo. A rise in the sea level would result in increased salinity of inland water supplies, which may affect water treatment in these areas. Rising sea levels may also increase infiltration rates and alter the runoff regime of the sewage systems, which may affect the sanitary system.

Extreme climate changes may also affect the extraction, production and transportation of the materials necessary for our operations, such as water treatment materials, and may lead to an increase in the cost of these materials. A rise in air temperature could also increase consumer demand for water, increasing the need to expand both water supply and sewage treatment.

See "Item 3.D. Risk Factors—Risks Relating to Our Business—The enactment of new laws and regulations relating to climate change and the change 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".

Government Regulation

Basic sanitation services in Brazil are subject to an extensive federal, state and local legislation and regulation that, among other matters, regulates:

- § the granting of concessions to provide water and sewage services;
- § the development of public private partnerships;
- § the need of a public bidding process for the appointment of private water and sewage services providers;
- § the need of setting up an agreement for the appointment of public water and sewage services providers;
- § the joint management of public services through cooperation, allowing for a program agreement without the need for a public bidding process for the service provider, subject to the condition that the planning, execution and monitoring activities are not executed by the service provider;
- § minimum requirements for water and sewage services;
- § water usage;
- § water quality and environmental protection; and
- § governmental restrictions on the incurrence of indebtedness applicable to state-controlled companies.

General

Pursuant to Article 23 of the Brazilian Constitution, water and sewage services are the joint responsibility of the federal government, the states and the municipalities. Article 216 of the Constitution of the State of São Paulo provides that, by law, the State must provide the conditions for efficient management and adequate expansion of water

and sewage services rendered by its agencies and State-controlled companies or any other concessionaire under its control. State law authorized our formation to plan, provide and operate water and sewage services in the State and also acknowledged the autonomy of the municipalities.

Pursuant to Article 175 of the Brazilian Constitution, the rendering of public services, such as water and sewage services, is the responsibility of the applicable public authority. However, any such public authority has the right to render these services directly or through a concession granted to a third party.

In Brazil, there are three federal legal regimes for contracting water and sewage services: (i) public concessions, regulated by Law No. 8,987/1995, which require a prior public bidding process; (ii) administration of public services through cooperation agreements between the federal government and local public authorities at State and municipal level without the need for a public bidding process, regulated by the Public Consortia and Cooperation Agreement Law; and (iii) public-private partnerships, regulated by Law No. 11,079/2004, used to grant concessions to private companies to provide public services and used in relation with construction works associated with the provision of public services. Until 2005, we had adopted the regime for public concessions. Following the entry into force of the Public Consortia and Cooperation Agreement Law, we adopted the administration of public services through cooperation agreements, which can be used alongside the other two regimes.

The Public Consortia and Cooperation Agreement Law and the Basic Sanitation Law have caused significant impacts in the development of the state sanitation policy and the regulatory structuring of the industry.

Because we are the legal concessionaire for the State of São Paulo for water and sewage services, serving approximately 59% of the State's population and providing sanitation services through concession agreements, the Consortium Law affects us on the expiry of our concession agreements entered into in the 1970s when the Brazilian Sanitation Plan (*Plano Nacional de Saneamento*), or PLANASA, was created. The Consortium Law has caused important changes in the relationship among municipalities, states and public sanitation service providers, most notably in mixed capital companies, such as us, because of the implementation of the program agreements as a substitute for concession agreements.

In addition, the Basic Sanitation Law in its role as a general guideline for the development of the Brazilian sanitation industry, addresses the conditions for the delegation of water and sewage services, the exercise of ownership by the granting authority and the regulatory conditions for the industry. The Basic Sanitation Law also provides for a significant amendment to Article 42 of the Concessions Law, which establishes the termination of concessions prior to the expiration date and the reversibility conditions for unamortized assets. The amendment requires that the service provider be compensated for unamortized assets, prioritizing an agreement between the parties setting out the criteria for calculation and payments of indemnity.

The Basic Sanitation Law

On January 5, 2007, the Federal Law No. 11,445, or the Basic Sanitation Law, was enacted, establishing nationwide guidelines for basic sanitation and seeking to create appropriate solutions for the situation of each state and municipality, facilitating the technical cooperation between the state and municipalities. In addition, the federal government will enact its public policy to facilitate access to financing alternatives that are compatible with the costs and terms of the sanitation industry, in substitution of the PLANASA model. On June 21, 2010, the federal government enacted Federal Decree No. 7,217, regulating the Basic Sanitation Law. See "Risk Factors—Risks Relating to our Business—We cannot anticipate the effects that further developments of the Basic Sanitation Law and its interpretation will have on the basic sanitation industry in Brazil and on us."

The Basic Sanitation Law establishes the following principles for basic sanitation public services: universalization, integrality, efficiency and economic sustainability, transparency of actions, social control and integration of infrastructure and services with the management of water resources. It does not define the ownership of the sanitation services, but establishes the minimum liability for the exercise of ownership, such as the development of the sanitation plan, definition of the person responsible for regulation and control, establishment of the rights and obligations of the users and of the social control mechanisms. It also defines the regionalized performance of the services (*i.e.*, one single provider serves two or more owners, for which there may be one plan for the combination of services).

In addition, the Basic Sanitation Law defines the guidelines and objectives of the federal basic sanitation policy to be observed when securing public funds generated or operated by agencies or entities of the federal government, and foresees the possibility of having subsidies as an instrument of social policy to ensure access to basic sanitation services to everyone, particularly the low-income population. The subsidies may be granted either directly, through tariffs or indirectly, depending on the characteristics of the beneficiaries and on the source of the funds.

Furthermore, the Basic Sanitation Law also provides that the sanitation services may be interrupted by the service provider, in the event of default of payment of the tariffs by the customer, among other reasons, after written notice, as long as minimum health requirements are met.

The Basic Sanitation Law also establishes the criteria for the reversal of assets at the time of termination of the agreement and with regard to the concessions, such as those that have expired or are effective for an indefinite term, or those that were not formalized by an agreement. In addition, the Basic Sanitation Law provides the basis for calculating the amount of an indemnity due, which must be calculated by a specialized institution chosen by mutual agreement between the parties.

Pursuant to the Basic Sanitation Law, the parties of the concession may enter into an agreement with respect to the payment of the indemnification due to the concessionaire. However, in the absence of an agreement, the Basic Sanitation Law establishes that the indemnification must be paid in no more than four equal and successive annual installments, with the first installment payable by the last business day of the fiscal year in which the assets are reversed.

Tariff Regulation in the State of São Paulo

The tariffs for our services are subject to Federal and State regulation.

On December 16, 1996, the governor of the State of São Paulo issued a decree which approved the existing tariff system and allowed us to continue to set our own tariffs. We used to set our tariffs based on the general objectives of maintaining our financial condition and preserving "social equality" in terms of the provision of water and sewage services to the population while providing a return on investment. The governor's decree also directs us to apply the following criteria in determining our tariffs:

§ category of use;

§ capacity of the water meter;

§ characteristics of consumption;

§ volume consumed;

§ fixed and floating costs;

§ seasonal variations of consumption; and

§ social and economic conditions of residential customers.

With the enactment of the Basic Sanitation Law and Federal Consortium Law, we are prohibited from planning, overseeing and regulating services, which includes determining the tariff policy to be adopted. Such activities are to be exercised by the owner of the concession. Other than the responsibility for planning, the remaining activities may not be delegated.

The current tariff structure maintains different tariff schedules, depending upon whether a customer is located in the São Paulo metropolitan region or the Regional systems. There are four levels of volume consumed for each category of customer, except for the residential social and *favelas* (shantytowns). The residential social tariffs apply to residences of low income families, residences of persons unemployed for up to 12 months and collective living residences. The favela tariffs apply to residences in shantytowns characterized by a lack of urban infrastructure. The latter two sub categories were instituted to assist lower income customers by providing lower tariffs for consumption. Customers are billed on a monthly basis. Water and sewage bills are based upon water usage determined by monthly water meter readings. Larger customers, however, have their meters read every 15 days to avoid nonphysical losses resulting from faulty water meters. Sewage billing is included as part of the water bill and is based on the water meter reading. We are also authorized to enter into individual contracts with certain customers, such as municipalities, to supply water or sewage services on a wholesale basis.

Before the enactment of the Basic Sanitation Law in 2007, we were subject to a federal law which limited the return on assets for water and sewage services to 12.0% per annum. Return on our assets was calculated using operating income (before financial and certain other expenses) measured against our operational assets (property, plant and equipment and certain other assets), based on our financial statements prepared in accordance with the accounting practices adopted in Brazil, or Brazilian GAAP. The Basic Sanitation Law revoked this law and extinguished this rule. Pursuant to the Basic Sanitation Law, tariff regulation is to be performed by an independent regulatory entity. Municipalities can either create their own regulatory agency or delegate tariff regulation to the ARSESP. With respect to the criteria to calculate the return on assets, on July 30, 2010, the ARSESP adopted a new methodology for the calculation of return on assets, which uses the replacement cost of the assets (assuming replacement with new assets) as a basis for the calculation. Although the ARSESP has proceeded with public consultations on tariff methodology and has indicated that it will implement the new methodology by 2012, we cannot assure you when the new rules will be enacted. Meanwhile, the ARSESP has not altered the tariff formula and has continued to apply the same methodology as in prior years.

Since 2008, the ARSESP has been developing new concepts in the tariff structure and adjustment formula. In July 30, 2010, the ARSESP published Resolution No. 156 establishing the methodology and general criteria for the definition of our regulatory asset base, in order to move forward with the tariff review process and to define the initial parameters of the auditing process that the ARSESP will have to conduct pursuant to the terms of the Basic Sanitation Law. The methodology has been defined and, in general terms, assets will be evaluated by reposition costs and weighted by the respective usage ratio.

In March 2011, the ARSESP published the tariff review schedule and opened a public hearing for the proposed methodology for the calculation of the weighted average cost of capital (WACC). In May 2011, the ARSESP released a regulatory post-tax weighted average cost of capital of 8.06%. In October 2011, we presented to the ARSESP a detailed business plan that disclosed requested information regarding our income, expenses and capital expenditures, so that the ARSESP could set an adjustment formula for our tariffs.

In January 2012, the ARSESP commenced a public consultation regarding our methodology for tariff revisions. The public consultation aims to: (i) set the initial framework for periodic tariff revisions for all municipalities we serve that are under the supervision of the ARSESP; (ii) discuss the criteria adopted to determine the cost of services, the tariff framework and the subsidies policy, among other issues; (iii) create a methodology, standards and procedures for future revisions and adjustments; and (iv) ensure the broad involvement of municipalities, concessionaires, consumers, investors and others.

In 2010, the ARSESP defined the rules to evaluate our asset base (Rule No. 156/2010). We have hired companies to conduct such an evaluation using this methodology and by August 2012, we will present to the ARSESP the evaluation of our asset base according to reposition cost and weighted by the respective usage ratio in accordance with ARSESP Rule No. 156/2010, on which our regulatory remuneration will be based. We will also present ARSESP with a detailed business plan that will serve as a basis for the final tariff methodology process to be released by the ARSESP in the near future. In September 2012, we expect to receive the ARSESP's preliminary average tariff proposal and the applicable efficiency gains factor that we will be required to include in the tariff structure proposal that the ARSESP will then request from us. By October 2012, we expect to be able to propose such tariff structure, and our preliminary average tariff, efficiency gains factor and tariff structure will then be submitted for public hearing. The ARSESP estimates that a final public hearing at which our preliminary average tariff, efficiency gains factor and tariff structure will be subjected to public scrutiny will be scheduled by November 2012. The aforementioned schedule may, however, suffer alterations or be subject to delays. We cannot anticipate the additional changes that the ARSESP will implement on our tariff structure and adjustment formula or the effects that these changes will have on us. If the changes are unfavorable to us, they could materially and adversely affect us.

Furthermore, since Law No. 11,445 permits municipalities to create their own regulatory agencies rather than being subjected to overview by the ARSESP, a number of municipalities created their own regulatory agencies. The municipality of Lins, which had decided in 2007 to create its own regulatory authority, revised this decision in 2010 and transferred the regulation of the water activities performed in Lins, including the setting of tariffs to the ARSESP. Lins has retained, however, the power to ultimately approve the tariff set by the ARSESP. The municipalities of São Bernardo do Campo and Magda retained the power to readjust the tariffs applied therein. Additionally, the municipalities in which the hydrographic basins of the rivers Piracicaba, Capivari and Jundiaí are located have created a consortium for regulation and supervision of our activities in that area. As this entity has recently been created, we cannot predict how it may implement regulatory changes that may affect our activities. If other municipalities create new agencies, we will be subject to their regulation, supervision and limitations to our services. See "Risk Factors—Risks Relating to Our Business—We cannot anticipate the effects that further developments of the Basic Sanitation Law and its interpretation will have on the basic sanitation industry in Brazil and on us".

Consumer Relations in the State of São Paulo

Pursuant to the Basic Sanitation Law, in 2009, the ARSESP enacted certain rules establishing (i) the general conditions for the services we render, (ii) the communication process for any failure in our services; (iii) penalties for deficiencies in the provision of basic sanitation services; and (iv) procedures for confidential treatment of our clients' private information. We are currently evaluating the enforceability and legality of some of these rules. Implementation of these rules started during 2011 and is expected to continue for the next few years. The implementation of these rules will impact our commercial and operations processes and may adversely affect us as described below and in other ways we cannot currently predict.

In particular, regarding changes to the general conditions for our services, in 2011 the ARSESP altered the standard contract that we are required to use in our relationships with retail costumers. The ARSESP changed the rule regarding the collection of water and sewage tariff, requiring that collection be directed to the consumer of our services, rather than to the owner of the served property, as used to be the case. We estimate that this change will affect ongoing legal disputes, particularly those regarding collection procedures, as well as business discussions in general. However, we are not currently able to predict the impact of this change on our business, as the change is still being implemented.

Regarding changes to the communication process for the reporting of failures, the ARSESP has modified the rules and standards for supervision and reporting of incidents. We have implemented these requested changes. Currently. part of the reporting of incidents occurs online, through the Incident Reporting System ("*Sistema de Comunicação de Incidentes*") established by the ARSESP, implementing more transparency and control in our operations.

We are attentive to these regulatory changes, have been working toward meeting the ARSESP's requirements and recommendations, and have presented technical, legal and factual reasons for any conduct that the ARSESP may find irregular. As a result we are subject to few regulatory infractions and to limited fines. See "Risk Factors—Risks Relating to Our Business—We cannot anticipate the effects that further developments of the Basic Sanitation Law and its interpretation will have on the basic sanitation industry in Brazil and on us".

Concessions

Concessions for providing water and sewage services are formalized by agreements executed between the state or municipality, as the case may be, and a concessionaire to which the performance of these services is granted in a given municipality or region. Our concessions normally have a contractual term of up to 30 years. However, our concessions in general can be revoked at any time if certain standards of quality and safety are not met, or in the event of default of the terms of the concession agreement.

A municipality that chooses to assume the direct control of its water and sewage services must terminate the current relationship by duly compensating the service provider. Subsequently, the municipality will be in charge of rendering services or of conducting a public bidding process to grant the concession to potential concessionaires, including agreements with public companies directly. Although the Constitution of the State of São Paulo determines that the relevant municipality would have to pay us for the unamortized book value of the assets related to the concession and assume any corresponding debt, with the exclusion of any amounts that have been paid to us by the municipality, upon termination or non-renewal of the concession, the payment for termination may not be effected immediately, and any termination could negatively affect our cash flows, operating results and financial situation. See "Item 3.D. Risk Factors—Risks Relating to Our Business—Municipalities may, under certain circumstances, terminate our concessions before their expiration and the indemnification may be inadequate to recover the full value of our investments."

The Federal Concessions Law No. 8,987/1995 and the State Concessions Law No. 7,835/1992 require that the granting of a concession by the government be preceded by a public bidding process. However, the Federal Public Bidding Law No. 8,666/1993, which establishes the rules for the public bidding process, provides that a public bidding process can be waived under certain circumstances, including in the case of services to be provided by a public entity created for such specific purpose on a date prior to the effectiveness of this law, provided that the contracted price is compatible with what is practiced in the market. Furthermore, a provision of the Federal Public Bidding Law, as amended by the Public Consortia and Cooperation Agreement Law, provides that the program contracted can be executed with waiver of a public bidding process.

In the majority of municipalities where we operate, the new contracts have been formalized pursuant to the provisions of the Federal Public Bidding Law that allows the public bidding process to be waived under certain circumstances. However, due to the discussion over whether the State or municipal authorities have the right to grant rights to provide basic sanitation services in municipal areas, negotiations of the terms of our new contract for the provision of water and sewage services in the city of São Paulo, were more complicated. See "Related Party Transactions Agreement with the State and the City of São Paulo".

On June 18, 2009, Municipal Law No. 14,934/2009 was enacted and this law revoked Law No. 13,670/2003, which had originally created the discussion on whether the State or the Municipality was the one with the powers to grant

and monitor formal concessions for water and sewage services in the city of São Paulo. Although the new law authorized the city of São Paulo to enter into an agreement with us, because the issue of authority between the State or municipal government remain under judicial review, on June 23, 2010, we entered into a formal agreement with both the State and the city of São Paulo to regulate the provision of water and sewage services in the city of São Paulo for a 30-year period, which may be extended for an additional 30-year period.

Public Consortia and Cooperation Agreement Law for Joint Management

On April 6, 2005, the federal government enacted Federal Law No. 11,107, or the Federal Public Consortia and Cooperation Agreement Law, which regulates Article 241 of the Brazilian Constitution. This statute provides general principles to be observed when a public consortia enters into contracts with the Brazilian political divisions and subdivisions (the federal government, states, the Federal District and municipalities) aiming at the joint management of public services of common interests.

Federal Decree No. 6,017/2007 details the conditions of establishment of joint management and the execution of the program agreement regulating the Public Consortia and Cooperation Agreement Law. This federal legislation introduces significant changes in the relationship among municipalities, states and companies providing public sanitation services, prohibiting the latter from exercising activities of planning, oversight and regulation, including tariff regulation, of the services and creating the program agreement for contracting entities whose share control is held by one of the Brazilian political divisions and subdivisions upon waiver of the public bidding process and compliance with concession legislation, as applicable.

On January 13, 2006, the Governor of the State of São Paulo enacted State Decree No. 50,470, amended by State Decrees No. 52,020, dated July 30, 2007, and No. 53,192, dated July 1, 2008, which provide for the rendering of water and sewage services in the State of São Paulo. According to these decrees, we may enter into agreements with municipalities in connection with the provision of water and sewage services by means of the so-called "program agreement without a public bidding process". In addition, these decrees establish that we will continue to render services in the areas covered by the concession granted by the State.

Based on these statutes, in January 2007 we executed our first program agreement with the municipality of Lins, located in the State of São Paulo. Subsequently, we formalized agreements with other municipalities in the State of São Paulo. These other municipalities transferred the oversight and regulation of our services to the State of São Paulo through a cooperation agreement.

On June 8, 2006, the State of São Paulo enacted Decree No. 50,868 creating the Commission for the Regulation of Sanitation Service of the State of São Paulo (*Comissão de Regulação do Serviço de Saneamento do Estado de São Paulo – CORSANPA*) to regulate sanitation services. The Commission for the Regulation of Sanitation Service of the State of São Paulo is directly subordinated to the State Secretariat for Sanitation and Water Resources.

The main duty of the Commission for the Regulation of Sanitation Service of the State of São Paulo was conducting studies for the creation of a regulatory agency for the basic sanitation industry and the presentation of legal and regulatory measures. The completion of such duties resulted in the publication of supplementary Law No. 1,025 of December 7, 2007, which created the ARSESP. Furthermore, Supplementary Law No. 1,025/2007 maintained the State Sanitation Council (*Conselho Estadual de Saneamento – CONESAN*), created by Supplementary Law No. 7,750/92, as an advisory council to define and implement the state basic sanitation policy, and the State Sanitation Fund (*Fundo Estadual de Saneamento - FESAN*). The State Sanitation Fund is connected to the State Secretariat for Sanitation and Water Resources, and collects and manages resources that support State-approved programs, as well as the development of technology, management and human resources and a sanitation information system, in addition to other support programs.

The ARSESP regulates the basic sanitation services that belong to the State, relating to the federal and municipal jurisdictions and prerogatives, and is responsible for:

- § the compliance with and enforcement of state and federal basic sanitation legislation;

- the publication of the organizational platform for the services, indicating the types of services provided by the State, as well as the equipment and facilities that compose the system;

- the acceptance, where applicable, of the legal attributions of the jurisdictional authority;

- the establishment, in accordance with the tariff guidelines defined by Decree No. 41,446/96, of tariffs and other methods that provide compensation for our services, adjustment and review of such tariffs and methods to ensure the financial-economic balance of services and low-cost tariffs through mechanisms that increase service efficiency and lead to the distribution of productivity gains to society; and

- the approval, oversight and regulation (including tariff issues) of the sewage treatment and wholesale water supply agreements entered into between the state supplier and other suppliers, pursuant to Article 12 of the Basic Sanitation Law.

With respect to municipal basic sanitation, the ARSESP oversees and regulates services (including tariff issues) that have been delegated by municipalities to the State as a result of cooperation agreements, that authorize program agreements between the municipalities and us for as long as it is convenient to the municipality's public interest.

For its services, the ARSESP charges 0.50% of the annual total invoice from sales and services (excluding revenues relating to the construction of concession infrastructure) of the municipality. This fee is collected from municipalities that have a signed program agreement with us and the municipalities located in the metropolitan regions.

In connection with the scope of our services, Supplementary Law No. 1,025/2007 expanded the range of services that we can render, with the inclusion of urban rainwater drainage and management, urban cleaning and solid waste management, as well as the operation of power generation, storage, conservation and sales activities, for our own or third-party use.

In addition, the rules simplified the process for the expansion of our business in Brazil and abroad, authorizing us:

- to participate in the controlling block or the capital of other companies;
- to create subsidiaries, which may become majority or minority shareholders in other companies; and
- to establish partnerships with national or foreign companies, including other state or municipal basic sanitation companies in order to expand our activities, share technology and expand investments related to basic sanitation services.

Public-Private Partnerships

The PPP is a form of agreement with the public administration used for the concession of services to private enterprises, as well as for construction works coupled with the provision of services. PPPs are regulated by the State of São Paulo through Law No. 11,688, which was enacted on May 19, 2004. PPPs may be used for: (i) implantation, expansion, improvement, reform, maintenance, or management of public infrastructure; (ii) provision of public services; and (iii) exploitation of public assets and non-material rights belonging to the State.

Payment is conditional upon performance. The payment may be collected through: (i) tariffs paid by users; (ii) use of resources from budget; (iii) assignment of credits belonging to the State; (iv) transfer of rights related to the commercial exploitation of public assets; (v) paper of assets; (vi) paper from public debts; and (vii) other revenues.

In our case, payment is conditional upon performance and is collected through the use of resources from the budget.

Public Financing

In January 2007, the President of Brazil announced a new Growth Acceleration Plan, known as the “PAC”, which includes major investments in infrastructure services, including the provision of water and sewage, housing, as well as highways, airports, ports and energy services, that would benefit the poor population of Brazil. PAC calls for a total investment of R$504.0 billion through 2010, including a R$40.0 billion investment in the sanitation sector. The majority of the investment of the PAC would be provided by State-owned companies and the private sector, while the rest would come from the federal government. Of the amounts dedicated to the sanitation sector, we have obtained various loans from the BNDES and Caixa Econômica Federal totaling R$2.8 billion, the proceeds of which are being used to fund various projects. See “Item 5. Operating and Financial Review and Prospects—Liquidity and Capital Resources—Indebtedness Financing.”

Public Bidding Procedures

Pursuant to the Federal Public Bidding Law, the public bid process commences with publication by the granting authority in a federal, state or municipal official newspaper, as the case may be, and another leading Brazilian newspaper. The publication announces that the granting authority will carry out a public bidding contest pursuant to provisions set forth in an *edital* (invitation to bid). The invitation to bid must specify, among other terms: (i) the purpose, duration and goals of the bid; (ii) the participation of bidders, either individually or forming a consortium; (iii) a description of the qualifications required for adequate performance of the services covered by the bid; (iv) the deadlines for the submission of the bids; (v) the criteria used for the selection of the winning bidder; and (vi) a list of the documents required to establish the bidder's technical, financial and legal capabilities.

The invitation to bid is binding on the granting authority. Bidders may submit their proposals either individually or in consortia, as provided for in the invitation to bid. After receiving proposals, the granting authority will evaluate each proposal according to the following criteria, which must have been set forth in the invitation to bid:

- § the technical quality of the proposal;
- § lowest cost or lowest public service tariff offered;
- § a combination of the criteria above; or
- § the largest amount offered in consideration for the concession.

The provisions of State Law No. 6,544 of November 2, 1989, as amended, or the State Public Bidding Law, parallel the provisions of the Federal Public Bidding Law. The Federal and State bidding laws will apply to us in the event that we seek to secure new concessions. Moreover, these bidding laws currently apply to us with respect to obtaining goods and services from third parties for our business operations or in connection with our capital expenditure program, in each case subject to certain exceptions.

Water Usage

State law establishes the basic principles governing the use of water resources in the State of São Paulo in accordance with the State constitution. These principles include:

- § rational utilization of water resources, ensuring that its primary use is to supply water to the population;
- § optimizing the economic and social benefits resulting from the use of water resources;
- § protection of water resources against actions which could compromise current and future use;
- § defense against critical hydrological events which could cause risk to the health and safety of the population or economic and social losses;
- § development of hydro-transportation for economic benefit;
- § development of permanent programs of conservation and protection of underground water against pollution and excessive exploitation; and
- § prevention of soil erosion in urban and rural areas, with a view to protecting against physical pollution and silting of water resources.

Under State law, implementation of any project that involves the use of surface or underground water requires prior authorization or licensing from the competent government authority. In order to implement these principles, authorizations granting a right of use are required from the relevant public authority for water usage (whether for collection, release of effluents or otherwise), modification of the regime and modification of the quality or the quantity of the existing water. In the case of rivers under the federal government's domain (rivers crossing more than one state), ANA is the public authority which grants the authorization. With respect to the rivers under a state's domain,

the applicable state authority has jurisdiction to grant the right of use. In the State of São Paulo, DAEE is the public authority responsible for granting such authorizations. DAEE has, as its objectives, establishing (i) a policy for the use of water resources with a view to developing the water business of the State, and (ii) plans, studies and projects related to the use of water resources, directly or by means of agreements with third parties.

Our main operating units have been granted water usage rights; however, we also have several operating units where water grants are not fully in place. To help obtain the remaining water grants, we have established a corporate program for the legalization and maintenance of grants.

In July 2000, ANA was established to develop the National System for Water Resources Management. According to existing law, the hydrographic basins committees are authorized to charge users, such as us, for the abstraction of water from, or dumping of sewage into, water bodies controlled by these agencies. Since 2003 and as of December 31, 2011, we have paid R$93.3 million to ANA and the State Secretariat for the Environment (*Secretaria do Estado do Meio Ambiente*), and these agencies have used these amounts to pay for expenses related to the National and the State Systems for the Management of Water Resources (*Sistema Nacional e Sistema Estadual de Gerenciamento de Recursos Hídricos*) and principally to sponsor studies, programs, projects and constructions provided for in the Water Basin Plan (*Plano de Bacia*). Resources for these projects may be loaned or provided to governmental agencies and corporations, including us, for use in projects related to the conservation and recovery of water resources.

State Law No. 12,183, which was enacted on December 29, 2005, established the basis for charging for the use of the water resources under the domain of the State of São Paulo. To apply such charging, the law provides for, among other provisions, the formulation of criteria by the basin committees, the creation of basin agencies and the organization of a registered list of water resource users. The basin committee's proposals regarding the criteria to calculate the amounts to be charged at each basin must be approved by the State Water Resource Council, and formalized by a decree issued by the State Governor.

Water Quality

Administrative Rule No. 2,914/2011, issued by the Ministry of Health of the federal government, provides the standards for potable water for human consumption in Brazil. This rule is similar to the U.S. Safe Drinking Water Act and the regulations enacted by the U.S. Environmental Protection Agency, which establishes rules for sampling and limits related to substances that are potentially hazardous to human health.

In compliance with Brazilian law, the physical-chemical, organic and bacteriological analyses carried out for water quality control follow the methodologies of the Standard Methods for Water and Wastewater (21st edition) of the American Water Works Association.

Decree No. 5,440/2005 provides that the quality of water must be disclosed to consumers. We have been complying with this regulation by publishing the required information in monthly bills and annual reports delivered to all consumers that we serve.

Environmental Regulation

The implementation and operation of water and sewage systems are subject to strict federal, state and municipal laws and regulations on environmental and water-resource protection. The National Environmental Council (*Conselho Nacional de Meio Ambiental*), or the CONAMA, is the federal agency responsible for the regulation of potentially polluting activities. In the State of São Paulo, the Companhia Ambiental do Estado de São Paulo, or CETESB, is the governmental entity responsible for the control, supervision, monitoring and licensing of polluting activities, pursuant to State Law No. 997 of 1976 and State Law No. 13,542 of 2009. The CETESB regulates the control of environmental pollutants.

The control and environmental planning instruments are defined by several legal instruments, such as State Law No. 997/1976, which regulates the environmental pollution control; the CONAMA Resolution No. 05/1988, which requires licensing of sanitation projects that cause significant alterations to the environment; the CONAMA Resolution No. 237/1997, which regulates (i) environmental licenses, (ii) the federal, state and local jurisdiction over environmental issues, (iii) the list of activities subject to licensing; and (iv) environmental impact studies and reports; State Decree No. 47,400/2002 and related articles from State Law No. 9,509/1997 regarding environmental licensing; and State Decree No. 8,468/76, the CONAMA Resolution No. 357/2005, the CONAMA Resolution No. 397/08 and the CONAMA Resolution No. 430/11 and the granting of rights for using and interfering with water resources (*Portaria Departamento de Águas e Energia Elétrica 717/96*). Projects with significant environmental impact are subject to specific studies prepared by multidisciplinary teams that present a series of recommendations focused on minimizing the environmental impact. These studies are then submitted for analysis and approval by the government authorities. The licensing process is composed of three stages, including the following licenses:

- § preliminary license – granted in the planning stage, approving the location and concept and attesting to the project's environmental feasibility;

- installation license – authorizing the beginning of works for the installation of the project, subject to compliance with approved plans, programs and projects, including environmental control measures and other necessary technical requirements; and

- operation license – authorizing the operation of a unit or activity, subject to compliance with the technical requirements contained in the installation license.

We have established a program (*Programa Corporativo de Manutenção e Regularização de Licenciamento Ambiental*) to obtain all necessary licenses in an effort to bring us into full compliance with environmental regulations within five years. As of the date of this annual report, we were not in possession of all licenses required in connection with our operations. Our failure to obtain such licenses may result in the imposition of fines and penalties. With respect to new operations, feasibility and environmental compliance are carried out throughout the project.

Sewage Requirements

State law sets forth regulations regarding pollution control and environmental preservation in the State of São Paulo. State law establishes the conditions and limitations for waste discharge that impacts water, air and soil. According to this law, in areas in which there is a public sewage system, all effluents of a "polluting source" must be discharged to such system. It is the responsibility of the polluting source to connect itself to the public sewage system. All effluents to be discharged are required to meet the standards and conditions established by the applicable environmental law, which allows such effluents to be treated by our treatment facilities and discharged in an environmentally safe manner. Effluents that do not comply with such criteria are prohibited from being discharged into the public sewage system. State legislation also establishes that liquid effluents, except those related to basic sanitation, be subjected to pre-treatment so that they meet the required mandatory levels before being discharged into the public sewage system. National sanitation guidelines are also established in Article 45 of Federal Law No. 11,455/2007.

The CETESB is authorized under State law to monitor discharges of pollutants into the environment and to enforce the requirements of State law. The CETESB is responsible for issuing preliminary installation and operation licenses granted to the pollution sources, including sewage treatment facilities.

The CETESB also regulates the discharge of effluents into water bodies and must approve all of our treatment facilities in accordance with federal and state regulations. State and federal water resource legislation establish the charging of fees for the discharge of treated effluents into water bodies. This provision is already in force in relation to some water basins, and is in different stages of implementation in remaining basins. See "—Government Regulation—Water Usage."

Governmental Restrictions on Incurrence of Debt

On June 30, 1998, the CMN issued Resolution No. 2,515/98 amending certain conditions that must be observed with respect to the external credit operations (i.e., foreign currency borrowings) of states, the Federal District of Brasilia, municipalities and their respective *autarquias* (agencies), foundations and non-financial companies, including us. This resolution provides, among other things, that, with certain exceptions applicable to the importation of goods and services:

- the proceeds of external credit operations must be exclusively used to refinance outstanding financial obligations of the borrower, with preference given to those obligations that have a higher cost and a shorter term, and, until used for such purposes, the proceeds shall remain deposited, as directed by the Central Bank, in a pledged account; and

- the total amount of the contractual obligation must be subject to monthly deposits in a pledged account, equal to the total debt service obligation, including principal and interest, divided by the number of months that the obligation is to be outstanding.

The CMN resolution further provides that the requirements described above do not apply to financing transactions involving multilateral or official organizations such as the International Bank for Reconstruction and Development, or IBRD, the IADB or the JICA. The Central Bank regulation implementing this resolution provides, among other things, that the account referred to in the first bullet point above must be an account opened in a federal financial institution, which is to hold such funds until released for the purpose of refinancing outstanding obligations of the borrower. The Central Bank regulation further provides that the account described in the second bullet point above must be an escrow account to be opened in a federal financial institution and to secure the payment of principal and interest on the external debt.

Our foreign currency-denominated transactions are also subject to the approval of the National Secretariat of Treasury (*Secretaria do Tesouro Nacional*) and the Central Bank. After reviewing the financial terms and conditions of the transaction, the National Secretariat of Treasury and the Central Bank will issue an approval for the closing of the foreign exchange transaction relating to the entry of the funds into Brazil and, following such entry and at our request, an electronic certificate of registration through which all scheduled payments of principal, interest and expenses will be remitted by us. The electronic certificate of registration grants the borrower access to the market for foreign exchange.

Lending Limits of Brazilian Financial Institutions

The CMN Resolution No. 2,827 of March 30, 2001, as amended, limits the amount that Brazilian financial institutions may lend to public sector companies, such as us. Financing of projects which are put up for international bid and any financing in *reais* provided to the Brazilian counterpart of such international bids are excluded from these limits.

Scope of Business

State Law No. 12,292, dated of March 2, 2006, amended State Law No. 119, dated of June 29, 1973, which created our Company, authorizes us to provide water and sewage services outside São Paulo (in other states of Brazil and other countries). This law also authorizes us to own interests in other public or private-public companies and Brazilian or international consortiums. In addition, this law permitted us to incorporate subsidiaries and enter into a partnership with or acquire interests in a private company with a corporate purpose related to the sanitation business.

C. Organizational structure

Not applicable.

D. Property, Plant and Equipment

Our principal property, plant and equipment comprise administrative facilities which are stated at historical costs less depreciation. The reservoirs, water treatment facilities, water distribution networks consisting of water pipes, water mains, water connections and water meters, sewage treatment facilities, and sewage collection networks consisting of sewer lines and sewage connections are recorded as intangible assets (concession assets). As of December 31, 2011, we operated through 66,389 kilometers of water pipes and mains and 45,073 kilometers of sewer lines. As of that same date, we operated 212 water treatment facilities and 490 sewage treatment facilities, as well as 16 water quality control laboratories.

We own our headquarters building and all other major administrative buildings. We have pledged some of our properties as collateral to the federal government in connection with a long-term financing transaction we have entered into with the IBRD that was guaranteed by the federal government. We have also pledged part of our assets in the amount of R$249.0 million as collateral as of December 31, 2011, with respect to our indebtedness under the Special Program for Payment of Federal and Social Security Related Taxes in Installments (*Programa de Parcelamento Especial para Impostos Federais e Previdenciários*), or PAES program.

As of December 31, 2011, the total net book value of our property, plant and equipment and intangible assets (including concession assets) was R$20,498.1 million.

All of our material properties are located in the State of São Paulo.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following management's discussion and analysis of financial condition and results of operations should be read in conjunction with our audited consolidated financial statements included elsewhere in this annual report. The consolidated financial statements included elsewhere in this annual report have been prepared in compliance with IFRS as issued by the IASB. This annual report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements as a

result of various factors, including, without limitation, those set forth in “Risk Factors.”

In the following discussion, references to increases or decreases in any period are made by comparison with the corresponding prior period, except as the context otherwise indicates.

A. Operating and Financial Review and Prospects

Overview

As of December 31, 2011, we operated water and sewage systems in the State of São Paulo, including in the city of São Paulo, Brazil’s largest city, and in 363 municipalities in the State of São Paulo, which represented 56.3% of all municipalities in the State. We also provided water services on a wholesale basis to six municipalities located in the São Paulo metropolitan region and to the municipality of Sumaré in which we did not operate water systems.

The São Paulo metropolitan region, which includes the city of São Paulo, is our most important service region. With a total population of approximately 20.4 million, the São Paulo metropolitan region accounted for 75.6%, 74.5% and 73.9% of our gross revenue from sales and services in 2009, 2010 and 2011 (excluding revenues relating to the construction of concession infrastructure), respectively. 60.6% of the concession intangible assets reflected on our balance sheet as of December 31, 2011 was located in this region. In an effort to respond to demand in the São Paulo metropolitan region and because the region represents the principal opportunity to increase our net revenue from sales and services, we have concentrated a major portion of our capital expenditure program to expand the water and sewage systems and to increase and protect water sources in this region. Our capital expenditure program is our most significant liquidity and capital resource requirement.

Factors Affecting Our Results of Operations

Our results of operations and financial condition are generally affected by our ability to raise tariffs, general economic conditions in Brazil and, in some previous periods, meteorological conditions.

In 2008, our net income was strongly affected by the global financial and economic crisis, which began in 2008 and whose effects were still present in 2009, resulted in a depreciation of the Brazilian *real* against the U.S. dollar, which adversely affected our obligations denominated in foreign currency.

In order to ensure its economic and financial strength, we have been working on increasing our efficiency and productivity gains. For this reason, we have attempted to reduce costs. In 2009, we decreased our staff by 9.3% pursuant to an Agreement for the Adjustment of Conduct (*Termo de Ajustamento de Conduta*), or TAC, with the State Public Attorney's Office (*Ministério Público Estadual*). Pursuant to the TAC, we laid off retirees who were still working for us and laid off employees representing approximately 2% of our workforce. Our results of operations for the 2009, 2010 and 2011 fiscal years were also affected by a provision for severance payments in the amount of R$146.6 million for employees who resigned in 2009, R$19.0 million for employees who resigned in 2010 and R$47.0 million for employees who resigned in 2011.

In 2011, our costs and expenses increased 15.7% compared to a decrease of 25% in our net income. In 2011, the volume invoiced increased 3.1% compared to 2010. The other increases are mainly related to depreciation and amortization, wages, the agreement with São Paulo and credits write-off, which amount to R$216.2 million, R$405.5 million, R$166.4 million and R$112.1 million, respectively.

Effects of Tariff Increases

Our results of operations and financial condition are highly dependent upon our ability to increase tariffs for our water and sewage services. Since the enactment of the Basic Sanitation Law in 2007, as a general rule, regulatory agencies will be responsible for setting, adjusting and reviewing tariffs, taking into consideration, among other factors, the following:

§ political considerations arising from our status as a State-controlled company;

§ anti inflation measures enacted by the federal government from time to time; and

§ when necessary, the readjustment to maintain the original balance between each party's obligation and economic gain (*equilíbrio econômico-financeiro*) under the agreement.

Readjustment of our tariffs continues to be set annually and depend on the parameters established by the Basic Sanitation Law and the ARSESP. The guidelines also establish procedural steps and the terms for annual adjustments. The annual adjustments must be announced 30 days prior to the effective date of the new tariffs, which take effect in September and remain in place for a period of at least 12 months. See "4.B. Business Overview—Tariffs."

The following table sets forth, for the periods indicated, the percentage increase of our tariffs, as compared to three inflation indexes:

	Year ended December 31,		
	2009	**2010**	**2011**

Increase in average tariff(1)	4.4%	4.1%	6.8%
Inflation – IPC – FIPE	3.7%	6.4%	5.8%
Inflation – IPCA	4.3%	5.9%	6.5%
Inflation – IGP-M	(1.7)%	11.3%	5.1%

(1) Since 2007, tariff readjustments have taken effect in September, one month after the readjustment announcement.

Sources: Central Bank, *Fundação Getulio Vargas*, or FGV, and *Fundação Instituto de Pesquisas Econômicas*.

Effects of Brazilian Economic Conditions

As a company with all of its operations in Brazil, our results of operations and financial condition are affected by general economic conditions in Brazil, particularly by exchange rate fluctuations, inflation rates and interest rate levels. For example, the general performance of the Brazilian economy affects our cost of capital and inflation affects our costs and margins. The Brazilian economic environment has been characterized by significant variations in economic growth rates.

General Economic Conditions

The year 2008 was characterized by the worsening of the global financial and economic crisis. As a result, the *real* depreciated by 32.0% against the U.S. dollar in 2008. Nonetheless, at December 31, 2008, Brazil had R$206.8 billion in currency reserves and a trade surplus of R$24.8 billion. The average unemployment rate in Brazil's principal metropolitan regions was 6.8% in 2009. The crisis' main effect on the Brazilian economy was a decline in expectations for economic activity in 2009 and, to a lesser extent, in 2010. The year of 2011 was marked by the economic crises in the Euro zone. In Brazil, there was a depreciation of 12.6% of the Brazilian real against the US dollar and Brazilian GDP increased by 2.7%.

In 2009, Brazilian GDP decreased 0.2% in comparison with 2008. Nonetheless, at that same year Brazil had US$239.1 billion in currency reserves and its trade surplus was US$25.3 billion. The average unemployment rate in Brazil's principal metropolitan regions remained stable at 6.8% in 2009.

In 2010, Brazilian GDP increased 7.5% in comparison with 2009. At that same year, Brazil had US$288.6 billion in currency reserves and its trade surplus was US$20.3 billion. The average unemployment rate in Brazil's principal metropolitan regions was 6.7% in 2010.

In 2011, Brazilian GDP increased 2.7% in comparison with 2010. At that same year, Brazil had US$352 billion in currency reserves and its trade surplus was US$29.8 billion. The average unemployment rate in Brazil's principal metropolitan regions was 6% in 2011.

Interest Rates

High domestic interest rates result in increases in our financial expenses and also negatively affect our ability to obtain financing, on a cost-effective basis, in the domestic capital and lending markets. As a result, we may continue to require substantial amounts of foreign currency-denominated indebtedness in order to satisfy our liquidity and funding requirements, which may increase our exposure to exchange rate fluctuations, as discussed below.

The official interest rate set by the Central Bank, the SELIC overnight rate, was 13.66% as of December 31, 2008. In 2009, in order to boost the economy, the Central Bank reduced the official interest rate significantly, reaching 8.65% as of December 31, 2009. In 2010, the Central Bank increased interest rates, and the official interest rate, as defined by the SELIC overnight rate target, was 10.66% as of December 31, 2010. As of December 31, 2011, the SELIC overnight rate, was 10.91%. We have not utilized any derivative financial instruments or any hedging instruments to mitigate interest rate fluctuations. We do, however, continually monitor market interest rates in order to evaluate the possible need to refinance our debt.

Inflation

Inflation affects our financial performance by increasing our costs of services rendered and operating expenses. In addition, all of our *real*-denominated debt is indexed to take into account the effects of inflation. Most of our *real*-denominated debt provides for inflation-based increases in the respective principal amounts of that indebtedness, which are determined by reference to the daily government reference interest rate (*Taxa Referencial*), or TR, plus an agreed margin. We cannot assure you that our tariffs will be increased, in future periods, to offset, in full or in part, the effects of inflation.

Currency Exchange Rates

We had total foreign currency-denominated indebtedness of R$3,053.4 million as of December 31, 2011, of which R$189.4 million relates to our short-term foreign currency-denominated obligations. In the event of significant devaluations of the *real* in relation to the U.S. dollar or other currencies, the cost of servicing our foreign currency-denominated obligations would increase as measured in *reais*, particularly as our tariff and other revenue are based solely in *reais*. In addition, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. For example, the 32.0% devaluation of the *real* in 2008 increased our financial expenses and negatively affected our overall results of operations for the year. In contrast, the 25.5% appreciation of the *real* against the U.S. dollar in 2009 led to a foreign exchange gain of R$528.4 million. In 2010, the 4.3% appreciation of the *real* against the U.S. dollar led to a foreign exchange gain of R$66.1 million. In 2011, the 12.6% depreciation of the *real* against the U.S. dollar led to a foreign exchange loss of R$382.3 million.

We manage our indebtedness portfolio closely to decrease the cost of servicing our indebtedness as a whole and our exposure to exchange rate fluctuations. We do not speculate in foreign currencies, and we do not have any exposure to derivatives tied to foreign currencies.

The following table shows the fluctuation of the *real* against the U.S. dollar, the period-end exchange rates and average exchange rates as of or for the periods indicated:

	Year ended December 31,		
	2009	**2010**	**2011**
Depreciation (appreciation) of the *real* versus U.S. dollar	(25.5)%	(4.3)%	12.6%
Period-end exchange rate – US$1.00	R$1.741	R$1.666	R$1.876
Average exchange rate – US$1.00(1)	R$1.994	R$1.759	R$1.675

(1) Represents the average for period indicated.

Source: Central Bank.

From time to time, we may enter into forward exchange transactions to mitigate foreign currency exposure. In addition, we have monitored, overseen and controlled our foreign currency-denominated indebtedness, taking advantage of market opportunities to improve the profile of our indebtedness and reduce our costs. As of December 31, 2011, we had no outstanding forward exchange transactions.

Effects of Climate Change (Drought and Intense Rainfalls)

We operate in a region of Brazil that has been prone to droughts, although historically droughts have not impacted all of our water supply systems equally. Brazil experienced a prolonged and severe drought during 2000 and 2001. As a result, from mid-June to mid-September of 2000, we rationed water in the south of the São Paulo metropolitan region, affecting approximately 3.5 million people, or approximately 20% of the total population of this region, which reduced our total water production by approximately 8%. From April 2001 through January 2002 and from October to December 2003, we also rationed water in certain regions of the São Paulo metropolitan region, but on a much smaller scale. This rationing on a smaller scale caused our total water production volume to be reduced by only 0.8%. The effects of the drought continued to affect our systems through 2004. Due to the water usage reduction bonus program that we operated from March to September 2004, when rainfall was extremely low and our reservoirs were at correspondingly low levels, and the return to normal rainfall levels that occurred throughout 2004 and early 2005, the conditions of our reservoirs improved in 2005. In 2006, rainfall was sufficient to enable us to maintain our reservoirs at levels reflecting the historic average. In 2007 and 2008, rainfall exceeded the levels of previous years, increasing the volume of water held in our reservoirs and thereby providing a cushion to meet demand. In 2009, rainfall levels were higher than the historic average and by the end of 2009, our reservoirs had a utilization rate of 87.0%, compared to a 50.0% and 41.0% utilization as of December 31, 2008 and 2007, respectively. In 2011, rainfall levels were slightly lower than historical averages and occurred during unusual times of year. As of December 31, 2011, our reservoirs had a utilization rate of 62.8%, compared to a 74.4% utilization as of December 31, 2010.

Critical Accounting Estimates and Assumptions

We make estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amount of our assets and liabilities within the next financial year are addressed below.

Allowance for Doubtful Accounts

We record an allowance for doubtful accounts in an amount that our management considers sufficient to cover probable losses, based on an analysis of customer accounts receivable, in accordance with the accounting policy stated in Note 2.8 to our consolidated financial statements as of and for the years ended December 31, 2009, 2010 and 2011. Provisions for the allowance for doubtful accounts are included in selling expenses, net of recoveries. The net charge to this allowance was R$117.4 million, R$232.5 million and R$120.4 million in 2009, 2010 and 2011, respectively.

The methodology for determining the allowance for doubtful accounts requires significant estimates, considering a number of factors, including historical collection experience, current economic trends, estimates of forecast write-offs, the aging of the accounts receivable portfolio and other factors. While we believe that the estimates used are reasonable, actual results could differ from those estimates.

Fair Value of Financial Instruments

In accordance with Brazilian GAAP, management estimates the fair value of financial instruments using information available in the market and appropriate estimating methodologies. Management uses considerable personal judgment to interpret the information available in the market when developing estimates of fair value. Therefore, the estimates presented may not necessarily indicate the value that would be obtained for the financial instruments if they were realized on the market. The use of different market assumptions and/or estimating methodologies could have a material effect on the estimated fair values.

Indemnities Receivable

Indemnities receivable is a long-term asset representing amounts receivable from the municipalities of Diadema and Mauá as indemnification for their unilateral termination of our water and sewage service concessions in 1995. As of each of December 31, 2009 and 2010, this asset amounted to R$146.2 million. In 2011, the Company decided to record a provision for losses related to the amount receivable from Mauá due to the uncertainty and recognized only the amount receivable from Diadema, since there is an ongoing negotiation. The amount receivable from Diadema amounted as of December 31, 2011, to R$60.3 million.

Prior to their termination, pursuant to our concession contracts, we invested in the construction of water and sewage systems in these municipalities to meet our concession service commitments. Upon the unilateral termination of the concessions by the municipalities of Diadema and Mauá, our assets were impounded by the municipal authorities, which took on the responsibility of providing water and sewage services in these areas. At that time, we reclassified our property, plant and equipment balances relating to the impounded assets as long-term assets (indemnities receivable) and recorded impairment charges to reduce the carrying value of the assets to the estimated recoverable amounts which we had contractually agreed as fair compensation with these municipal authorities.

Our rights to recover these amounts are being disputed by the municipalities, and no amounts have been received to date. Based on the advice of legal counsel, we continue to believe that we have the right to receive those amounts, and we continue to monitor the status of the legal proceedings. The ultimate amounts to be received however, if any, will most likely be subject to a final court decision. Therefore, actual amounts received could differ from those recorded. For more information, see Note 9 to our consolidated financial statements as of and for the years ended December 31, 2011, 2010 and 2009.

Valuation of Long-Lived Assets

As of December 31, 2011, we had property, plant and equipment and intangible assets of R$356.5 million and R$20,141.7 million, respectively.

We review long-lived assets, primarily buildings, water and sewage system assets and concession intangible assets to be held and used in our business, for the purpose of determining and measuring impairment on a recurring basis or when events or changes in circumstances indicate that the carrying value of an asset or group of assets may not be recoverable. According to IFRS, we evaluate possible impairment by determining whether projected future operating income is sufficient to absorb the depreciation or amortization of long-lived assets, within the context of the balance sheet as a whole.

Studies supporting the write-offs for obsolescence and abandonment of projects are conducted in the accounting period of the write-offs based on discounted cash flow projections, and approved by our board of directors. We monitor the carrying value of our property, plant and equipment on an on-going basis and adjust the net book value to

assure future projected operations will be sufficient to recover the carrying value of the assets.

In evaluating impairment of our long-lived assets, we make significant assumptions and estimates regarding matters that are inherently uncertain, including projections of future operating income and cash flows, future growth rates and the remaining useful lives of the assets, among other factors. In addition, projections are computed over an extended period of time, which subjects those assumptions and estimates to an even larger degree of uncertainty. While we believe that the estimates we use are reasonable, the use of different assumptions could materially affect our valuations.

Amortization of Intangible Assets

Amortization is calculated when the intangible assets are available for use in the necessary condition established by the Company.

Amortization reflects the period over the expected future economic benefits generated by the intangible asset and can be the period of the contract, depending on the contract. The utilization of the assets is related to the useful life of the assets constructed by the Company and amortization of the intangible assets is considered in the calculation of the tariff.

Amortization of the intangible assets finishes when the asset is totally consumed or is alienated, not being considered in the calculation of the tariff any longer, whichever occurs first.

Depreciation of Property, Plant and Equipment

Depreciation of our property, plant and equipment, primarily buildings, water and sewage service and other assets acquired, is provided using the straight-line method based on the estimated useful lives of the underlying assets. While we believe that our estimates of current remaining estimated lives is reasonable, the use of different assumptions and estimates and changes in future circumstances, could affect the remaining useful lives of our asset, which could have a significant impact on our results of operations in the future.

Provision for Contingencies

As of December 31, 2011, we were party to judicial and administrative proceedings, relating to civil, environmental and tax matters, amounting to R$1,571.8 million (excluding the amount of R$120.7 million related to court deposits) with respect to which we considered the risk of loss as probable. As of that date, proceedings with respect to which we considered the risk of loss as possible amounted to R$2,621.8 million, and those with respect to which we considered the risk of loss as remote amounted to R$19,958.3 million.

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among other types, disputes with customers and suppliers and tax, labor, civil, environmental and other proceedings. For a more detailed discussion of these legal proceedings, see Note 15 to our consolidated financial statements as of and for the years ended December 31, 2009, 2010 and 2011. We accrue for probable losses resulting from these claims and proceedings when we determine that the likelihood that a loss has occurred is probable and the amount of such loss can be reasonably estimated. Therefore, we are required to make judgments regarding future events for which we often seek the advice of legal counsel. As a result of the significant judgment required in assessing and estimating these provisions for contingencies, actual losses realized in future periods could differ significantly from our estimates and could exceed the amounts which we have provisioned.

Pension Plans

The present value of the pension obligations depend on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of pension obligations.

We determine the appropriate discount rates at the end of each year, which is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information on the pension plans under Plan G0 and G1 is disclosed in Note 16.

Differences in actual experience or changes in assumptions could affect the carrying amount of pension obligations and expenses recognized in our results.

Certain Transactions with Controlling Shareholder

Reimbursement Due from the State

Reimbursement due from the State for pensions paid represent supplementary pensions (Plan G0) that we pay, on behalf of the State, to former employees of State-owned companies which merged to form our Company. These amounts must be reimbursed to us by the State, as primary obligor.

In November 2008, we entered into the third amendment to the agreement with the State relating to payments of pension benefits made by us on its behalf. The State acknowledged that it owed us an outstanding balance of R$915.3 million as of September 30, 2008, relating to payments of pension benefits made by us on its behalf. We provisionally accepted, but it is not recognized in our books, the reservoirs in the Alto Tietê System as partial payment in the amount of R$696.3 million, subject to the transfer of the property rights of these reservoirs to us. Since November 2008, the State has been paying the remaining balance in the amount of R$219.0 million in 114 successive monthly installments. See Note 8 to our consolidated financial statements as of and for the years ended December 31, 2009, 2010 and 2011 and “Item 7. Major Shareholders and Related Party Transactions.”

Accounts Receivable from the State for Water and Sewage Services Rendered

Certain of these accounts receivable have been overdue for a long period, and we do not reserve against such accounts receivable as we fully expect to recover these amounts and loss is not considered probable. We have entered into agreements with the State with respect to these accounts receivable. For further information on these agreements, see Note 8 to our consolidated financial statements as of and for the years ended December 31, 2009, 2010 and 2011 and "Item 7. Major Shareholders and Related Party Transactions."

Use of Certain Assets Owned by the State

We currently use certain reservoirs in the Billings and Guarapiranga reservoirs which are owned indirectly by the State. We currently do not pay any fees with respect to the use of these reservoirs. However, we are responsible for maintaining and meeting the operating costs of these reservoirs. If these facilities had not been made available for our use, we would have had to obtain water from more distant sources, which would be more costly. The State does not incur operating costs on our behalf.

The arrangement for use of the Billings and Guarapiranga reservoirs is provided for through a grant issued by the DAEE. We have a right to use these reservoirs so long as we remain responsible for maintaining and meeting their operating costs.

Results of Operations

The following table sets forth, for the periods indicated, certain items in our statement of operations, each expressed as a percentage of net revenue from sales and services:

	Year ended December 31,					
	2009		**2010**		**2011**	
	(in millions of reais*, except percentages)*					
Net revenue from sales and services	8,579.5	100.0%	9,231.0	100.0%	9,941.6	100.0%
Cost of sales and services	(5,087.3)	(59.3)%	(5,194.5)	(56.3)%	(6,031.1)	(60.7%)
Gross profit	3,492.2	40.7%	4,036.5	43.7%	3,910.5	39.3%
Selling expenses	(610.4)	(7.1)%	(712.9)	(7.7)%	(619.5)	(6.2%)
Administrative expenses	(717.1)	(8.4)%	(653.2)	(7.1)%	(846.6)	(8.5%)
Other operating income (expenses), net	(44.4)	(0.5)%	1.8		(90.1)	(0.9%)
Operating profit	2,120.3	24.7%	2,672.2	28.9%	2,354.3	23.7%
Finance cost, net	(10.0)	(0.1)%	(379.4)	(4.1)%	(633.6)	(6.4%)
Profit before income tax and social contribution	2,110.3	24.6%	2,292.8	24.8%	1,720.7	17.3%
Income tax and social contribution	(602.6)	(7.0)%	(662.3)	(7.2)%	(497.3)	(5.0%)
Net income for the year	1,507.7	17.6%	1,630.5	17.7%	1,223.4	12.3%

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Net Revenue from Sales and Services

Net revenue from sales and services increased by R$710.6 million, or 7.7%, to R$9,941.6 million in 2011 from R$9,231.0 million in 2010. This increase was principally due to the increase in tariff rates to 6.83% in September

2011 from 4.05% in September 2010 and the 3.1% increase in sales volume.

Cost of Sales and Services

The cost of sales and services increased by R$836.6 million, or 16.1%, to R$6,031.1 million in 2011 from R$5,194.5 million in 2010. As a percentage of net revenue from sales and services, cost of sales and services increased to 60.7% in 2011 from 56.3% in 2010.

The increase in costs of sales and services was principally due to the following factors:

- an increase of R$216.2 million, or 41.3%, as a result of our increased amortization expense related to our intangible assets for the services contract entered into with the municipality of São Paulo as well as to 99 expired or informal agreements, which are in the process of being formalized as program agreements. During 2011, we had a full year of the amortization of intangible assets related to the services contract entered into with the municipality of São Paulo in 2010 and relating to those 99 expired or informal agreements. Under the aforementioned agreements, the related intangible assets generate greater amortization expense as they are amortized to zero (instead of a residual guaranteed amount reimbursed by the granting municipality at the end of the previous respective concession contracts). This increase is also due to the beginning of operations in 2011 of sites that had previously been under construction;

- an increase of R$198.9 million, or 20.2%, in salaries and related charges as a result of: (i) the R$61.2 million adjustment in 2010 of actuarial calculation due to the migration of employees from defined benefit plan to defined contribution plan "*SabesprevMais*"; (ii) an increase of R$18.1 million due to the payment of termination fees related to the terminated employees security fund ("*Fundo de Garantia por Tempo de Serviço*" or "FGTS") incurred as a result of increased layoffs in 2011; (iii) 8% salary readjustments since May 2011, which had a total impact of R$81.3 million; and (iv) the increase of R$21.6 million from the 2011 Cost of Sales and Services figure due to the higher expense relating to the profit sharing program as compared to 2010.

- an increase of R$166.4 million, or 82.1%, in general expenses, mainly due to the R$158.8 million provision (corresponding to 7.5% of the gross revenue of capital after deduction of COFINS and PASEP) pursuant to the agreement with the municipality of São Paulo;

- an increase of R$65.1 million, or 10.8%, in costs of outsourced services, mainly due to (i) water and sewage systems maintenance, which amounted to R$16.9 million; (ii) the R$14.7 million increase in the Alto Tietê PPP designated amount for the contract's second year, and the initiation of operations in September 2011; (iii) maintenance, in the amount of R$9.2 million, of water and sewer networks and connections in order to minimize losses and meet project deadlines set forth by the ARSESP; (iv) the transport of mud in the amount of R$7.1 million as a result of increased demand for water treatment, which causes increased quantities of mud to be transported; (v) an increase of R$6.3 million resulting from socio-environmental services established together with the municipality of São Paulo; (vi) R$4.4 million in costs related to mail and telegrams for the delivery of water bills in certain areas via post following judicial decisions; and (vii) vehicle rentals in the amount of R$2.8 million as part of the second phase of the renovation of our fleet. The increase in costs of outsourced services was partially offset by a decrease in telephone and data transmission charges in the amount of R$5.7 million, mainly due to the execution of a contract with Telecomunicações de São Paulo S.A. ("TELESP"), which involves landlines and long-distance data transfers as well as corporate cellular phones at lower costs to us.

- an increase of R$53.9 million, or 10.2%, in the cost of electric energy due to the increase in consumption and higher energy tariffs.

- an increase of R$18.3 million, or 13.4%, in water-treatment products, mainly due to: (i) an increase of approximately 43% in the consumption of polyaluminium chloride, readjusted by approximately 11%. This product was used principally in the Guaraú water treatment station in place of aluminum sulfate, guaranteeing maximum outflow without compromising the quality of the treated water. This increase was partially offset on R$2.0 million by the decrease of the use of activated charcoal due to climate conditions, as well as due to the decelerated proliferation of algae in the reservoirs of the Alto Tietê System and Guarapiranga/Billings.

- an increase of R$12.4 million, or 9.1%, in product-related expenses, mainly in connection with the maintenance of our water and sewer structure (in the amount of R$7.4 million) and with the increased expenses with fuel and lubricants for vehicles (in the amount of R$1.8 million), resulted from an increase of 22% in the fuel price and from the expansion of our vehicle fleet.

Gross Profit

As a result of the factors discussed above, gross profit decreased by R$126.0 million, or 3.1%, to R$3,910.5 million in 2011 from R$4,036.5 million in 2010. As a percentage of net revenue from sales and services, gross profit decreased to 39.3% in 2011 from 43.7% in 2010.

Selling Expenses

Selling expenses decreased by R$93.4 million, or 13.1%, to R$619.5 million in 2011 from R$712.9 million in 2010. As a percentage of net revenue from sales and services, selling expenses decreased to 6.2% in 2011 from 7.7% in 2010.

The decrease in selling expenses was primarily due to the following factors:

- a decrease of R$112.1 million, or 48.2%, in credit write-offs, mainly as a result of additional provisions established in 2010 of R$34.2 million related to private clients and R$139.1 million related to public municipal entities (R$54.8 million of which related to the municipality of São Paulo);

- a decrease of R$14.1 million, or 6.5%, in expenses with outsourced services mainly related to the agreement with municipality of São Paulo and the R$34.4 million decrease in the provision established in 2011 for new services to be provided under that agreement, and a R$4.9 million increase resulting from services provided to satisfy the schedule for implementing the Rationed Water Use Program ("*Programa de Uso Racional da Água*" or"PURA") in city schools. This decrease was partially offset by the following increases: (i) R$11.1 million in billing services, mainly resulting from new billing technology related to the reading of usage, issuance of bills and delivering bills, in addition to an increase in the number of connections and adjustments of the contracts in the metropolitan region of São Paulo; and (ii) expenses in the amount of R$3.3 million relating to services for the collection of credits.

- an increase of R$19.1 million, or 10.4 %, in the personel salaries and related charges as a result of: (i) the R$ 9.3 million adjustment in 2010 of the actuarial calculation due to the migration of employees from defined benefit plan to defined contribution plan "Sabesprev Mais"; (ii) a R$ 1.4 million increase due to the payment of termination fees related to the terminated employees security fund ("Fundo de Garantia por Tempo de Serviço") incurred as a result of increased layoffs in 2011; (iii) 8% salary readjustments since may 2011, which had a total impact of R$ 3.9 million.

- an increase of R$9.1 million, or 13.0%, in general expenses, mainly due to (i) water bills for banking institutions in the amount of R$4.2 million; and (ii) the R$3.3 million increase in tax provisions relating to the services rendered in the cities of São José dos Campos, Pindamonhangaba and Botucatu, resulting from increased collection during 2011 as compared to 2010;

- an increase of R$3.5 million, or 89.6%, in depreciation and amortization expenses, mainly due to the adjustment in amortization of intangible assets in connection with the agreement with the municipality of São Paulo.

Administrative Expenses

Administrative expenses increased by R$193.4 million, or 29.6%, to R$846.6 million in 2011 from R$653.2 million in 2010. As a percentage of net revenue from sales and services, administrative expenses increased to 8.5% in 2011 from 7.1% in 2010.

The increase in administrative expenses was primarily due to:

- an increase of R$187.4 million, or 79.6%, in salaries and related charges, mainly due to (i) the covering of actuarial liability in the amount of R$157.5 million related to the supplementary pension plan (plan G0) of the State of São Paulo (based on the non-recurring actuarial calculation performed on December 31, 2010); (ii) the cover of actuarial liability in the amount of R$22.2 million related to the supplementary pension plan (plan G0) of the State of São Paulo for 2011; (iii) a R$3.0 million increase due to the payment of termination fees related to the terminated employees security fund ("*Fundo de Garantia por Tempo de Serviço*" or "FGTS") incurred as a result of increased layoffs in 2011; and (iv) 8% salary readjustments since May 2011, which had the total impact of R$9.1 million;

- an increase of R$36.7 million, or 21.3%, in general expenses due to (i) the need for larger contingency provisions in the amount of R$59.7 million, particularly in connection with environmental issues in the municipalities of Guareí and Paraguaçu Paulista. This increase was partially offset by the R$17.9 million provisioning made in 2010 for losses relating to third party claims;

- a decrease of R$24.8 million, or 16.5%, in services provided by third parties in connection with a variety of matters, including: (i) a decrease of R$18.4 million in advertisement campaigns due to the termination of certain advertisement agreements; (ii) a R$5.5 million decrease due to reorganization and management performance related to the work of consultants and specialized service providers;

§ a decrease of R$3.1 million, or 12.2%, in depreciation expenses due to the decreased immobilized assets of the controlling shareholder.

Other Operating Income (Expenses), Net

Other operating income (expenses), net decreased by R$91.9 million in 2011, to R$90.1 million expense in 2011 from R$1.8 million income in 2010. This increase was primarily due to the provision made in the amount of R$85.9 million related to assets used for our concession in the municipality of Mauá, and to the write-off of assets in the amount of R$35.3 million.

Finance Cost, Net

Finance cost, net, consists primarily of interest on our indebtedness and foreign exchange losses (or gains) in respect of our indebtedness, offset partially by interest income on cash and cash equivalents and inflation based indexation accruals, mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Finance cost, net increased by R$254.2 million, or 67.0%, to R$633.6 million in 2011 from R$379.4 million in 2010. As a percentage of net revenues from sales and services, finance cost, net increased to 6.4% in 2011 from 4.1% in 2010.

The increase was principally due to:

§ an increase in foreign exchange loss related to loans and financing of R$448.5 million as a result of the 12.6% depreciation of the *real* against the U.S. dollar in 2011, compared to an appreciation of 4.3% of the *real* against the U.S. dollar in 2010;

§ a decrease of R$46.0 million in monetary indexation, mainly due to (i) a higher expense in 2010 amounting to R$20.0 million, due to the alteration of the unit price of our eleventh debentures issuance between their issuance date and their effective offering date in 2010; (ii) the depreciation of the *real* against the Japanese Yen upon the disbursement by Japan International Cooperation Agency (JICA) of R$14.0 million in 2011; and (iv) a decrease in the volume of refinancing of debt in 2011 as compared to 2010, amounting to a decrease of R$12.0 million;and

§ other monetary revisions relating to our contracts in the amount of R$41.2 million.

The increase in finance cost, net was partially offset by:

§ an increase of R$153.5 million in interest income and other financial income due to the increase in our cash and cash equivalents;

§ a decrease of R$95.5 million in financial expenses relating to judicial proceedings as a result of the lower interest income regarding the proceedings involving clients and service providers in 2011; and

§ a decrease of R$33.6 million in interest expenses mainly due to the amortization of our eighth and ninth debentures in June and October 2011, respectively.

Income before Income Taxes

As a result of the factors discussed above, income before income taxes decreased by R$572.1 million, or 24.9%, to R$1,720.7 million in 2011 from R$2,292.8 million in 2010. As a percentage of net revenue from sales and services, our income before income taxes increased to 17.3% in 2011 from 24.8% in 2010.

Income Taxes

Income taxes decreased by R$165.0 million, or 24.9%, to R$497.3 million in 2011 from R$662.3 million in 2010. The increase was primarily due to a decrease in taxable income in 2011.

Net Income

As a result of the factors discussed above, net income decreased to R$1,223.4 million in 2011 from R$1,630.5 million in 2010. Net profit margin decreased to 12.3% in 2011 from 17.7% in 2010.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009

Net Revenue from Sales and Services

Net revenue from sales and services increased by R$651.5 million, or 7.6%, to R$9,231.0 million in 2010 from R$8,579.5 million in 2009.

Net revenue from sales and services relating to water services increased by R$125.4 million, or 3.3%, to R$3,942.9 million in 2010 from R$3,817.5 million in 2009. This increase was principally due to:

- an average 3.8% increase in the volume of water invoiced 2010; and
- the effect of the 4.43% tariff increase in September 2009, and the 4.1% tariff increase in September 2010.

Net revenue from sales and services relating to sewage services increased by R$244.5 million, or 8.4%, to R$3,157.5 million in 2010 from R$2,913.0 million in 2009. This increase was principally due to:

- an average 4.5% increase in the volume of sewage services invoiced in 2010; and
- the effects of the 4.43% tariff increase in September 2009 and the 4.1% tariff increase in September 2010.

Gross revenue from construction increased by R$90.9 million, or 4.5%, to R$2,130.7 million in 2010 from R$2,039.8 million in 2009.

Cost of Sales and Services

The cost of sales and services increased by R$107.2 million, or 2.1%, to R$5,194.5 million in 2010 from R$5,087.3 million in 2009. As a percentage of net revenue from sales and services, cost of sales and services decreased to 56.3% in 2010 from 59.3% in 2009.

The increase in costs of sales and services was principally due to the following factors:

- an increase of R$157.6 million, or 349.3%, in general costs on the provision of water and sewage services, of which R$167.2 million relates to a fee to the Fund of Environmental Sanitation and Infrastructure of the municipality of São Paulo which had to be paid according to the terms of the agreement with the State and the city of São Paulo executed on June 23, 2010. This fee represents 7.5% of the gross revenue of the São Paulo municipality as from the date of execution of the agreement;
- an increase of R$71.4 million in construction costs in 2010;
- an increase of R$51.2 million, or 9.3%, in outsourced services, mainly due to (i) the maintenance of water and sewage structure amounting to R$18.4 million, (ii) pavement and maintenance of side-walks amounting to R$14.2 million, and (iii) transportation of water and mud amounting to R$8.4 million; and

- an increase of R$45.8 million, or 9.5%, in the electricity expense mainly due to (i) an increase of 5.2% in the electricity tariff, and (ii) an increase of 1.9% in the electricity consumption.

The increase in costs of sales and services was partially offset by:

- a decrease of R$196.8 million, or 16.7%, in salaries and related charges, mainly due to (i) a R$113.5 million decrease as a result of the reduction in our staff pursuant to the TAC, with the State Public Attorney's Office (*Ministério Público Estadual*). Pursuant to the TAC, we laid off retirees who were still working for us and laid off approximately 2% of our workforce; (ii) decrease in actuarial liability due to the migration from defined benefit plan to defined contribution plan amounting to R$79.3 million and (iii) a decrease of R$13.6 million related to adjustment in the profit sharing program for 2010;

- a decrease of R$14.7 million, or 2.7%, in depreciation and amortization expenses.

Gross Profit

As a result of the factors discussed above, gross profit increased by R$544.3 million, or 15.6%, to R$4,036.5 million in 2010 from R$3,492.2 million in 2009. As a percentage of net revenue from sales and services, gross profit increased to 43.7% in 2010 from 40.7% in 2009.

Selling Expenses

Selling expenses increased by R$102.5 million, or 16.8%, to R$712.9 million in 2010 from R$610.4 million in 2009. As a percentage of net revenue from sales and services, selling expenses increased to 7.7% in 2010 from 7.1% in 2009.

The increase in selling expenses was primarily due to the following factors:

- an increase of R$115.1 million, or 98.1%, in the allowance for doubtful accounts related to municipal public entities; and
- an increase of R$11.8 million, or 5.8%, in outsourced services expenses, principally due to (i) a R$9.7 million provision related to future payment to the City Hall of São Paulo (*Prefeitura Municipal de São Paulo*), or PMSP, pursuant to the agreement we entered into with PMSP on June 23, 2010; (ii) R$9.4 million in billing services, mainly related to an increase in network connections and the utilization of new technologies, which resulted in an increase in outsourcing expenses; and (iii) R$4.7 million related to increase in fraud control expenses.

The increase in selling expenses was partially offset by a R$28.2 million, or 13.3%, decrease in salaries and related charges in 2010, due mainly to: (i) the reduction in our staff pursuant to the TAC, which resulted in a decrease of R$15.5 million in 2010; (ii) gain from the migration of employees from defined benefit plan to defined contribution plan "*SabesprevMais*" amounting to R$13.3 million; and (iii) R$13.8 million decrease resulting from the implementation of the PURA program.

Administrative Expenses

Administrative expenses decreased by R$63.9 million, or 8.9%, to R$653.2 million in 2010 from R$717.1 million in 2009. As a percentage of net revenue from sales and services, administrative expenses decreased to 7.1% in 2010 from 8.4% in 2009.

The decrease in administrative expenses was primarily due to:

- a decrease of R$96.8 million, or 36.0%, in general expenses due to a reduction in contingency provisions mainly related to customer claims in 2010;
- a decrease of R$11.5 million in termination expenses resulting from the 2009 staff reduction pursuant to the TAC; and
- a decrease of R$13.9 million in actuarial calculation due to the migration of employees from defined benefit plan to defined contribution plan "*SabesprevMais*."

The decrease in administrative expenses was partially offset by:

§ an increase in actuarial liability related to the payment by us on behalf of the State of São Paulo of pension plan (plan G0) amounting to R$31.7 million due to a decrease in the discount rate from 6.6% to 6.0%;

§ an increase of R$19.2 million related to the deficit in defined benefit plan, paid to the employees who migrated to the defined contribution plan "*SabesprevMais*."

Other Operating Income (Expenses), Net

Other operating income (expenses), net increased to R$1.8 million income in 2010 from R$44.4 million expenses in 2009. The increase was due to the reclassification of the expenses related to the pension plan paid by us on behalf of the State of São Paulo (plan G0), which had been recorded as other operating expenses, net 2009, as administrative expenses in 2010.

Finance Cost, Net

Finance cost, net, consists primarily of interest on our indebtedness and foreign exchange losses (or gains) in respect of our indebtedness, offset partially by interest income on cash and cash equivalents and inflation based indexation accruals, mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Finance cost, net increased by R$369.4 million, or 3,694.0%, to R$379.4 million in 2010 from R$10.0 million in 2009. As a percentage of net revenues from sales and services, finance cost, net increased to 4.1% in 2010 from 0.1% in 2009.

The increase was principally due to:

- an increase in foreign exchange loss related to loans and financing of R$470.6 million as a result of the 4.3% appreciation of the *real* against the U.S. dollar in 2010, compared to an appreciation of 25.5% of the *real* against the U.S. dollar in 2009;
- an increase in interest expenses of R$91.0 million due to the issuance of (i) our tenth, eleventh and twelfth debentures in November 2009, March 2010 and July 2010, respectively; (ii) our fifth promissory notes in August 2010; and
- an increase of R$85.9 million in expenses from monetary indexation resulting mainly from the increase in the IGP-M rate of 11.3% in 2010 compared to its decrease of 1.7% in 2009.

The increase in finance cost, net was partially offset by:

- a decrease of R$158.7 million in expenses related to the adjustment for inflation of our provision for contingency due to a decrease in the inflation rate;
- an increase of R$65.2 million in financial income mainly due to (i) the renegotiation of debts with certain municipalities, mainly Taubaté and Ferraz de Vasconcelos, and (ii) the adjustment for inflation of court deposits; and
- an increase of R$59.3 million in interest and other financial income due to the increase in cash and cash equivalents.

Income before Income Taxes

As a result of the factors discussed above, income before income taxes increased by R$182.5 million, or 8.6%, to R$2,292.8 million in 2010 from R$2,110.3 million in 2009. As a percentage of net revenue from sales and services, our income before income taxes increased to 24.8% in 2010 from 24.6% in 2009.

Income Taxes

Income taxes increased by R$59.7 million, or 9.9%, to R$662.3 million in 2010 from R$602.6 million in 2009. The increase was primarily due to the increase in our income before income taxes in 2010.

Net Income

As a result of the factors discussed above, net income increased by R$122.8 million, or 8.1%, to R$1,630.5 million in 2010 from R$1,507.7 million in 2009.

B. Liquidity and Capital Resources

Capital Sources

In order to satisfy our liquidity and capital requirements, we have primarily relied on cash provided by operating activities, borrowings from Brazilian federal and state governmental financial institutions, and financing from multilateral organizations and from domestic and international capital markets. As of December 31, 2011, we had R$2,150.0 million of cash and cash equivalents. Outstanding short-term indebtedness was R$1,630.0 million as of December 31, 2011, of which R$189.4 million was denominated in foreign currency. Long-term indebtedness was R$6,966.3 million as of December 31, 2011, of which R$2,864.0 million consisted of foreign currency-denominated obligations. We believe that we have sufficient sources of liquidity and capital to meet our liquidity and capital requirements for the next few years, in light of our current financial position and our expected cash generated by operating activities.

Cash Provided by Operating Activities

Cash provided by operating activities is the single largest source of our liquidity and capital resources, and we anticipate that it will continue to be so in the future. Our cash generated by operating activities was R$2,072.5 million, R$2,083.0 million and R$2,717.1 million in 2009, 2010 and 2011, respectively.

We have overdue accounts receivable from the State and from the municipalities to which we provide water on a wholesale basis. For more information, see "Item 7.B. Related Party Transactions."

Indebtedness Financing

Our total financial indebtedness increased by 4.0%, from R$8,264.6 million as of December 31, 2010 to R$8,596.3 million as of December 31, 2011. In addition, during the same period, our total foreign denominated indebtedness recorded increased 35.8%, from R$2,248.9 million as of December 31, 2010 to R$3,053.4 million as of December 31, 2011, mainly related to investments from the Japan International Cooperation Agency, or the JICA, amounting to 19,169.0 million Yens or R$ 375.9 million, which will be invested in the Metropolitan Coastal Region. We also made significant amortization payments relating to certain Brazilian and foreign currency-denominated indebtedness.

As of December 31, 2011, we had R$6,966.3 million in long-term indebtedness outstanding (excluding the current portion of long-term indebtedness), of which R$2,864.0 million consisted of foreign currency-denominated long-term debt. We had outstanding short-term indebtedness of R$1,630.0 million as of December 31, 2011, representing the current portion of our long-term indebtedness. As of December 31, 2011, R$189.4 million of this short-term indebtedness was denominated in foreign currency. As of December 1, 2011, our Standard & Poor's Rating Service domestic rating was braAA+ and our S&P international rating was BB+.

Various contractual agreements we have entered into, including certain financing agreements with Caixa Econômica Federal and the BNDES, provide for liens over a portion of our cash flows from operations. In addition to Caixa Econômica Federal and the BNDES, we have granted liens over a portion of our cash flows deriving from our operations in connection with agreements relating to securitization transactions, the Alto Tietê PPP and arrangements relating to the lease of certain assets. Pursuant to these agreements, cash received from operations is required to pass through designated accounts. In the event of a default under the relevant agreement, such cash and future cash flows that are required to be deposited in such accounts become restricted and are subject to security interests in favor of the relevant creditor. As of December 31, 2011, a substantial portion of our monthly cash flows from operations was subject to these liens. As of that date, the total amount of our secured debt, including indebtedness benefiting from these liens, was R$2,546.9 million.

The following table sets forth information on our indebtedness outstanding as of December 31, 2011:

	As of December 31, 2011				
Facility	**Current**	**Long Term**	**Total Aggregate Principal Amount**	**Final Maturity**	**Interest Rate(1)**
	(in millions of reais*)*				
***Real*-denominated loans and financings:**					
Federal Government/Banco do Brasil	348.7	479.5	828.2	2014	8.50% plus UPR

Debentures Tenth Issuance	2.0	283.3	285.3	TJLP plus 1.92% (1st and 3rd series) and 9.53% plus 2020IPCA (2nd series)
Debentures Eleventh Issuance	202.5	1,005.7	1,208.2	CDI(3) plus 1.95% (1st series) and CDI plus 1.4% 2015(2nd series)
Debentures Twelfth Issuance	-	499.6	499.6	2025TR plus 9.5%
Debentures Thirteenth Issuance	599.4	-	599.4	2012CDI plus 0.65%
Debentures Fourteenth Issuance	-	279.8	279.8	TJLP plus 1.92% and 20229.19%
Debentures First Issuance – Aquapolo	-	160.1	160.1	2029TR plus 8.75%
Caixa Econômica Federal(2)	110.6	917.6	1,028.2	2011/20325.0% to 9.5% plus UPR
BNDES	37.6	3.5	41.1	3% plus TJLP (limited to 20136.00%)
BNDES (South coast area)	16.3	114.2	130.5	2.5% plus TJLP (limited 2019to 6.00%)
BNDES (PAC)	6.4	67.5	73.9	2.15% plus TJLP (limited 2023to 6.00%)
BNDES (Clean Wave Program)	14.3	235.4	249.7	1.92% plus TJLP (limited 2025to 6.0%)
Financial Leasing	-	49.6	49.6	
Other	1.8	3.5	5.3	12.00%, CDI and TJLP 2011/2018plus 6.00%
Interest and other charges	101.0	2.9	103.9	
Foreign currency denominated loans and financings:				
Inter-American Development Bank (IADB) US$386.9 million	71.6	652.1	723.7	1.14% to 3.29% plus currency basket fluctuation plus U.S. 2016/2035dollar
International Bank for Reconstruction and Development (IBRD) US$10.3 million	-	18.9	18.9	20340.43%
Eurobonds US$140.0 million	-	262.1	262.1	20167.50%
Eurobonds US$350.0 million	-	649.0	649.0	20206.30%
JICA Yen 39.5 billion	53.2	905.5	958.7	20290.01% to 2.5%
IADB AB Loan Financing US$226.1 million	44.9	376.4	421.3	20232.49% to 2.99%
Interest and Other Charges	19.7	-	19.7	
Total Debt	1,630.0	6,966.3	8,596.3	

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(1) UPR stands for Standard Reference Unit (*Unidade Padrão Referência*) and is equal to the TR, which was 0.09% per month as of December 31, 2011; CDI stands for Interbank Deposit Rate (*Certificado de Depósitos Interbancários*), which was 10.87% per annum as of December 31, 2011; IGP-M was 5.1% per annum as of December 31, 2011; TJLP stands for Long-term Interest Rate (*Taxa de Juros a Longo Prazo*), published quarterly by the Central Bank, which was 6.0% per annum as of December 31, 2011.

(2) This line item represents the aggregate amount outstanding under financing agreements we have entered into with Caixa Econômica Federal, which mature on different dates and bear different interest rates. The numbers above reflect the range of maturities and the weighted average interest rate under these agreements.

The following table shows the maturity profile of our debt, as of December 31, 2011, for the period indicated (in millions of reais):

	2012	2013	2014	2015	2016	After 2017	Total
Loans and financing	1,630.0	1,227.2	744.6	655.4	651.7	3,687.4	**8,596.3**

Substantially all of our foreign currency-denominated indebtedness of R$2,088.0 million as of December 31, 2011 was denominated in U.S. dollars or in baskets of foreign currencies. This indebtedness consisted principally of:

- R$723.7 million (US$386.9 million) in U.S. dollar denominated loans contracted with the Inter-American Development Bank, or the IADB, composed of the following: (i) loan to finance the first phase of the Tietê Project in 1992 and its second phase in 2000, under which payments of principal are made in semi-annual installments with final maturity in July 2025. The principal amount of this loan is adjusted semi-annually for the variation in a basket of foreign currencies U.S. dollar, and accrues interest at a rate varying from 1.14% to 3.29% plus LIBOR. We have pledged as collateral part of our receivables from our sales and services up to the amount due; (ii) credit agreement executed in September 2010 with the IADB for the financing of the third phase of the Tietê Project. This loan matures on September 3, 2035. Amortizations will be made in semi-annual installments after a grace period of six years. The principal amount accrues interest at the USD LIBOR.

- R$18.9 million (US$10.3 million) in U.S. dollar denominated loans from the International Bank for Reconstruction Development - IBRD which was entered into on October 28, 2009, amounting to US$ 100,000 thousand and will be amortized during the period of the contract, for the financing of the Water Source Program (Programa Mananciais). The loan matures in March, 2034. Amortizations will be in semi-annual installments starting on September 2019. The principal amount accrues interest at the USD LIBOR plus a variable spread.

- R$421.3 million (US$226.0 million) in U.S. dollar denominated loans from the AB Loan financing contracted with the IADB in May 2008. Under this loan, payments of principal are made in annual installments with final maturity in May 2023. The principal amount is adjusted semi-annually for the LIBOR plus spread and accrued interest at a rate varying from 2.49% to 2.99%. This loan was used to repay an outstanding series of debt securities in connection with the implementation of our investment plan; and

- R$911.1 million (US$490.0 million) in U.S. dollar denominated loans from Eurobonds contracted in November 2006 (US$140.0 million) and in December 2010 (US$350.0 million). Under this loan, payments of interest are made in semi-annual installments and

principal will be paid in the end of the contract with final maturities in 2016 and 2020. The interest rate for the November 2006 Eurobonds is 7.5% while for the December 2010 Eurobonds is 6.25%.

§ R$ 958.7 million (¥39,437.8 million) in Japanese yen denominated loans contracted with the JICA, composed of the following: (i) ¥21,316.0 million in Japanese yen denominated loans contracted with the JICA in August 2004 for the financing of the environmental recovery program for the Baixada Santista metropolitan region, called the Clean Wave Program (Programa Onda Limpa). Under this loan, payments of interest are made in semi-annual installments and principal will be paid in the end of the contract with final maturities in August 2029. The principal amount accrues interest at rates that vary from 1.8% to 2.5% per year; (ii) ¥6,208 billion in Japanese yen denominated loans contracted with the JICA in October 2010 for the financing of the environmental improvement program in the basin of the Billings dam, part of the New Life Program (Programa Vida Nova). The loan matures in October, 2035. Amortizations will be made in semi-annual installments after a grace period of seven years, starting on October 20, 2017. The principal amount accrues interest at a rate of 1.2% per year related to civil work and 0.01% per year related to consulting; and (iii) ¥19,169 billion in Japanese yen denominated loans contracted with the JICA in February 2011 to complement the financing for the first stage of the Clean Wave Program (Programa Onda Limpa), with commercial conditions similar to the ¥21,316.0 million loan entered into in August 2004. These funds will be used for the provision of works and services in the Baixada Santista metropolitan region. The credit agreement expires in 18 years and interest varies from 1.8% to 2.5% per year.

In February 2012, we contracted a ¥33,584 million Japanese yen denominated loan with the JICA for the financing of the Corporate Program for Water Loss Reduction. The loan matures on February 2037. Amortizations will be in semi-annual installments starting on September 2019. The principal amount accrues interest at a rate of 1.7% per year related to civil work and 0.01% per year related to consulting. As of the date of this annual report, no disbursement had been made under this agreement.

Our borrowings from multilateral institutions, such as the IADB and IBRD, have in the past been, and in the future are likely to be, guaranteed by the State or the federal government. We do not pay fees for these guarantees. Under some of the loan agreements with the IADB, we have granted a guarantee (*contra garantia*) to the federal government. For further information on the terms of these loan agreements, see "Item 4.A. History and Development of the Company—Capital Expenditure Program—Main Projects of Our Capital Expenditure Program—Metropolitan System Investment Program—Tietê Project";

For further information on the terms and guarantees of the financing agreements with the JICA, see "Item 7.B. Related Party Transactions—Government Guarantees of Financing" and "Item 4.A. History and Development of the Company—Capital Expenditure Program—Main Projects of Our Capital Expenditure Program—Metropolitan System Investment Program—Clean Wave Program".

Our outstanding domestic debt was R$5,542.9 million as of December 31, 2011 and consisted primarily of *real*-denominated loans from federal and state-owned banks, in particular, Banco do Brasil S.A., Caixa Econômica Federal and the BNDES, as well as debentures issued in November 2009, March 2010 September 2010, January 2011, February 2011, the first debentures issuance of our investee (Aquapolo) in August 2011 and financial leasing.

The following summarizes our principal borrowings from federal and State-owned banks:

- in March 1994, we entered into a loan agreement with Banco do Brasil S.A., or Banco do Brasil, in the amount of R$2.3 billion. Amortizations of the principal amount are made in 240 successive monthly installments, with final maturity in 2014. The principal amount accrues interest at the daily government interest rate plus 8.50% per annum and monetary adjustment;

- from 1996 to 2009, we have entered into several line of credit agreements with Caixa Econômica Federal, pursuant to which amortizations of principal are paid in 180 or 240 months in monthly installments commencing 30 days following the applicable grace period, which varies from 14 to 48 months from the date of signature of the line of credit agreement. The final maturity is 2032. The principal amount accrues interest from 5.0% to 9.5%. The lines of credit are collateralized by (i) collections of daily billings of water supply and sewage services up to the total amount of the debt, or (ii) by a monthly plan of billings corresponding to the minimum of three times the monthly charge, depending on the terms of the relevant line of credit agreement;

- in August 2002, we entered into a line of credit agreement with the BNDES. The final maturity date is February 2013. The principal amount accrues interest at the long-term rate fixed by the TJLP but limited to 6.0%, plus 3.0% per annum. If the TJLP exceeds 6.0%, such excess will be added to the principal amount payable at maturity. The line of credit agreement is collateralized by part of the billings from the provision of water and sewage services;

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- in November 2007, we entered into a R$129.9 million credit agreement with the BNDES. Amortizations of the principal amount will be made in 96 successive monthly installments, with final maturity in 2019. The principal amount accrues interest at the TJLP, but limited to 6.0%, plus 2.50% per annum. If the TJLP exceeds 6.0%, such excess will be added to the principal amount. The credit agreement is collateralized by part of the billings from the provision of water and sewage services;

- in May 2008, we entered into a R$174.0 million financing agreement with the BNDES. Amortizations of the principal amount will be made in 150 successive monthly installments, with final maturity in 2023. The principal amount accrues interest at the TJLP, but limited to 6.0%, plus 2.15% per annum. If the TJLP exceeds 6.0% per annum, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services;

- in March 2010, we entered into a R$294.3 million financing agreement with the BNDES. Amortizations of the principal amount will be made in 156 successive monthly installments commencing 30 days after the 24-month grace period, with final maturity in 2025. The principal amount accrues interest at the TJLP, but limited to 6.0%, plus 1.92% per annum. If the TJLP exceeds 6.0%, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services; and

- in 2011, we entered into financial leases in the total amount of R$49.6 million with certain contractors for the construction of infrastructure on land we own. During the construction phase, we recognize an intangible assets and the related liability of the lease at fair value. Upon the conclusion of the construction, which is estimated to June 2013, we start to pay the rental of the infrastructure (in 192 installments) and the lease is updated accordingly to the contract. On December 31, 2011, there were no constructions completed. These contracts are recognized as financial leasing.

Under the BNDES program, in the amount of R$826.1 million, we issued the first of three tranches of debentures. In November 2009, we issued our tenth debentures in the aggregate principal amount of R$275.4 million. The debentures are divided in three series: the first and second series will mature in November 2020 and the third in December 2020. The debentures of the first and third series, in the aggregate principal amount of R$77.1 million and R$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0%, such excess will be capitalized the 15th day of each month that such debentures are outstanding. The debentures of the second series, in the aggregate principal amount of R$82.6 million, bear interest at the rate of the IPCA index plus 9.53% per year. Our tenth issuance was entirely subscribed by the BNDES. We used the funds raised from this tenth issuance for investments primarily in the Corporate Program for Water Loss Reduction and on improvements and reforms of the Rio Grande's water treatment plant, including other projects for water supply and sewage collection systems in the São Paulo Northern Coast, Paraíba Valley and Mantiqueira Regions.

In April 2010, we issued in two series our eleventh issuance of debentures in the aggregate principal amount of R$1,215.0 million. The first and second series will mature in March 2015 and 2013, respectively. The debentures of the first series, in the aggregate principal amount of R$810.0 million, bear interest at the CDI plus 1.95% per year, and the second series, in the aggregate principal amount of R$405.0 million, bear interest at the CDI plus 1.4% per year. The net proceeds from our eleventh issuance of debentures were partially used to redeem the promissory notes issued in December 2009. The remaining portion was used for general corporate purposes.

In June 2010, we issued 500,000 debentures to the Government Severance Indemnity Fund for Employees (*Fundo de Garantia por Tempo de Serviço*), or FGTS, based on the FGTS's program to finance companies in the sanitation, transport and real estate businesses (our twelfth issuance). The proceeds will be released in three tranches within a six-month period each, totaling R$500.0 million in the aggregate, of which R$335 million was already released to us. The debentures will bear interest based on the TR plus 9.5% per year. The debentures will mature in June 2025. The debentures have a grace period of four years in respect of payments, and we have an option to redeem the debentures as from July 2014. We intend to use the proceeds from the twelfth issuance to fund a portion of our capital expenditure program in the water supply and sewage systems.

In January 2011, we issued in a single series our thirteenth debentures in the aggregate principal amount of R$600.0 million. The debentures will mature in August 2012 and bear interest, paid semi-annually, at the CDI rate plus 0.65% / 0.75% / 0.85% / 1.25% per year. The proceeds were used to redeem the promissory notes issued in August 2010.

On February 15, 2011, we issued 100 debentures subscribed exclusively by the National Bank for Economic and Social Development (BNDES). These debentures were distributed in three nonconvertible series, at a nominal value of R$ 2,753.70, totaling R$ 275.4 million. This transaction was settled on April 15, 2011, for all series. The funds raised in this issuance will be used in expenditures in water supply and sewage systems in the following projects: Water Treatment Stations at Rio Grande, Litoral Norte, Vale do Paraíba and Mantiqueira, Bacia do Piracicaba-Capivari-Jundiai; and for program of reduction of losses. The debentures will mature in March 2022 and bear interest, paid monthly, quarterly and semi-annually, depending on the period, at the TJLP rate plus 1.92% per year or 9.19% per year.

In August 2011, the joint-controlled entity “Aquapolo” issued 326,732 debentures, registered as its first issuance of simple debentures, nonconvertible, in a unique series amounting to R$326.7 million. The debentures will mature in August 2029 and bear interest, paid monthly, at the TR plus 8.75% per year.

All of our *real*-denominated indebtedness is indexed to take into account the effects of inflation. Most of our *real*-denominated debt provides for inflation-based increases in their respective principal amounts; the increases are determined by reference to the TR plus an agreed margin.

In March 2011, our securitization fund (*Fundo de Investimentos Creditórios*) created in 2006 in the amount of R$250 million expired. In addition, on June 1, 2011 the second series of our eighth issuance of debentures was paid in the amount of R$465.0 million.

In December 2010, we issued US$350.0 million aggregate principal amount of 6.250% senior unsecured notes due 2020. Interest on the notes will accrue from December 16, 2010 at a rate of 6.250% per year and will be payable semi-annually in arrears on June 16 and December 16, commencing on June 16, 2011. The notes will mature on December 16, 2020. The proceeds from the offering will be used to repay financial commitments throughout 2011.

In February 2012, we issued our fifteenth issuance of debentures in two series in the aggregate principal amount of R$771.0. The first and second series will mature in February 2017 and 2019, respectively. The debentures of the first series (in the aggregate principal amount of R$287.3 million) bear interest at a rate of CDI plus 0.99% per year. The second series (in the aggregate principal amount R$483.7 million) bears interest at a rate of IPCA plus 6.2% per year. The net proceeds from out fifteenth issuance of debentures were used to repay financial commitments throughout 2012.

Financial Covenants

We are subject to financial covenants under the agreements evidencing or governing our outstanding indebtedness.

Foreign currency denominated indebtedness

With respect to our indebtedness denominated in U.S. dollars or in baskets of foreign currencies, we are subject to financial covenants, including but not limited to those set forth in the loan agreements entered into with the IADB. Each of these agreements contains, among other provisions, limitations on our ability to incur debt.

The indenture relating to our US$140.0 million 7.5% notes due 2016 is the most stringent of these debt agreements. The indenture prohibits, subject to some exceptions, the incurrence of additional debt in the event that: (i) the ratio of Adjusted Total Debt to Adjusted EBITDA (as defined in the related indenture) is greater than 3.65x; or (ii) the Debt Service Coverage Ratio (as defined in the indenture) is less than 2.35x.

We do not believe that these covenants will impose constraints on our ability to finance our capital expenditure program or, more generally, to develop our business and enhance our financial performance.

Local currency denominated indebtedness

With respect to our outstanding indebtedness denominated in *reais*, we have entered into several credit agreements with the BNDES that requires us to maintain the following ratios:

Our credit agreements with the BNDES dated August 2002 and November 2007 require us to maintain: (i) an EBITDA/net operational income ratio equal to or higher than 38%; (ii) an asset/short-term liability (excluding the short-term portion of long-term liabilities) ratio higher than 1.0x; (iii) total connections (water and sewage)/employees ratio equal to or higher than 520; (iv) EBITDA/debt service equal to or higher than 1.5x; and (v) a shareholders' equity/total debt ratio equal to or higher than 0.8x.

Our credit agreement with the BNDES dated May 2008 requires us to maintain: (i) an EBITDA/net operational income ratio equal to or higher than 38%; (ii) an EBITDA/financial costs ratio equal to or higher than 2.35x; and (iii) a net bank debt/EBITDA equal to or higher than 3.2x.

Our credit agreement with the BNDES dated March 2010 requires us to maintain: (i) an EBITDA/net operational income ratio equal to or higher than 38%; (ii) an EBITDA/financial costs ratio equal to or higher than 2.35x; and (iii) net bank debt/EBITDA equal to or higher than 3.65%.

In addition, our BNDES financings have the following financial covenants: (i) EBITDA/net operational income ratio equal to or higher than 38%; and (ii) shareholders' equity/total debt ratio equal to or higher than 0.8x.

Pursuant to the terms of our credit agreements with the BNDES, the financial ratios mentioned above must be calculated based on our year end audited financial statements.

Although we have been presenting our financial information in our annual reports on Form 20-F in compliance with IFRS since fiscal year ended December 31, 2008, our Brazilian financial information was presented under Brazilian GAAP for fiscal years through December 31, 2009. Accordingly, compliance with the financial ratios mentioned above was calculated under Brazilian GAAP. Brazilian Corporate Law was recently amended to facilitate the convergence of Brazilian GAAP with IFRS, and thereafter the Accounting Pronouncement Committee (*Comitê de Pronunciamentos Contábeis*) issued several new accounting standards that progressively adapted Brazilian GAAP to IFRS (the new Brazilian GAAP). Beginning with the fiscal year ended December 31, 2010, all Brazilian publicly held companies, such as us, must report under the new Brazilian GAAP. Due to the impact of this change, we requested a temporary waiver from BNDES suspending compliance with these financial covenants in order to allow us to analyze the impact of the new Brazilian GAAP on our ability to comply with the financial ratios. BNDES granted the waiver on December 26, 2011, suspending compliance for 13 months beginning with December 2011.

In addition, all of our financing agreements with the Caixa Econômica Federal and most of our financing agreements with the BNDES are subject to a Performance Improvement Agreement (*Acordo de Melhoria de Desempenho*). The Performance Improvement Agreement, dated May 28, 2007, as amended, was entered into between us and the Federal government, and the Caixa Econômica Federal and the BNDES as intervening parties. Pursuant to this agreement, we must comply with eight financial and operating ratios during the next five years. If we fail to comply with any of these ratios, the Caixa Econômica Federal and the BNDES may suspend our credit lines and we will be prevented from entering into any other financing agreements with those entities. We have the ability, however, to renegotiate the ratios during the five-year period if needed.

Our financing agreement with the federal government and Banco do Brasil S.A. and our credit agreements with Caixa Econômica Federal do not contain material financial covenants.

With respect to our outstanding debentures, the eighth, ninth, eleventh and twelfth issuances require us to maintain a current debt ratio (current assets divided by current liabilities, excluding the current portion of long-term indebtedness) higher than 1.0x and an EBITDA/financial expenditures ratio equal to or higher than 1.5x.

The tenth issuance requires us to maintain (i) an EBITDA/net operational revenue ratio equal to or higher than 38 percent; (ii) an EBITDA/financial expenditures ratio equal to or higher than 2.35x; and (iii) a net bank debt/EBITDA ratio equal to or higher than 3.65x.

The thirteenth issuance requires us to maintain (i) an EBITDA/financial expenditures ratio equal to or higher than 1.5% and (ii) a net debt/EBITDA ratio equal to or higher than 3.65%.

As of the date of this annual report we were in compliance with all the financial ratios that are currently applicable to us.

Capital Requirements

We have, and expect to continue to have, substantial liquidity and capital resource requirements. These requirements include debt-service obligations, capital expenditures to maintain, improve and expand our water and sewage systems, and dividend payments and other distributions to our shareholders, including the State.

Capital Expenditures

Historically, we have funded and plan to continue funding our capital expenditures with funds generated by operations and with long-term financing from international and national multilateral agencies and development banks. We generally include in our capital expenditure program for the following year the amount of investment that was not realized in the previous year. In 2011, we recorded R$2.4 billion under our capital expenditure program. We have budgeted investments in the amount of approximately R$7.9 billion from 2012 through 2015.

Dividend Distributions

We are required by our bylaws to make dividend distributions, which can be made as payments of interest on shareholders' equity to our shareholders in an amount equal to or higher than 25% of the amounts available for distribution. We made aggregate distributions of R$394.2 million, R$456.0 million and R$578.7 million in 2009, 2010 and 2011, respectively.

On June 25, 2010, we paid R$198.1 million as dividends to the State. See "Item 7.B. Related Party Transactions—Dividends."

Market Risk

We are exposed to various market risks, in particular, foreign currency risk and interest rate risk. We are exposed to foreign currency risk because a substantial portion of our financial indebtedness is denominated in foreign currencies, primarily the U.S. dollar, while we generate all of our net operating revenues in reais. Similarly we are subject to interest rate risk based upon changes in interest rates, which affect our net financial expenses. For further information on our market risks, see Note 3.1 to our consolidated financial statements as of and for the years ended December 31, 2011, 2010 and 2009 included elsewhere in this annual report.

Exchange Rate Risk

As of December 31, 2009, 2010 and 2011, R$1,745.6 million, R$2,248.9 million and R$3,053.4 million, or 26.6%, 27.2% and 35.5%, respectively, of our debt obligations were denominated in foreign currencies (including debt pegged to baskets of foreign currencies). The basket of foreign currency-pegged debt consists primarily of our debt with the IADB. As a result, we are exposed to exchange rate risks that may adversely affect our financial condition and results of operations, as well as our ability to meet debt service obligations.

Exchange Rate Sensitivity

We estimate that the potential loss to us in connection with U.S. dollar-denominated debt that would have resulted as of December 31, 2009, 2010 and 2011 from each hypothetical instantaneous and unfavorable 1% change in the U.S. dollar against the *real* would have been approximately R$17.5 million, R$22.5 million and R$30.5 million, respectively. Consistent with these estimates, a hypothetical instantaneous and unfavorable 10% change in this exchange rate would have resulted in losses of approximately R$174.6 million, R$224.9 million and R$305.3 million as of December 31, 2009, 2010 and 2011, respectively. These estimates do not take into account that the changes in exchange rates comprising the baskets of foreign currencies often present variations different from the devaluation of the *real* in relation to the U.S. dollar.

The fluctuation of the *real* in relation to the U.S. dollar and with the IADB and IBRD basket of currencies, for the years ended December 31, 2009, 2010 and 2011 were as follows:

Year ended December 31,

	2009	2010	2011
		(in percentages)	
Depreciation (appreciation) of the *real* in relation to the U.S. dollar	(25.5)	(4.3)	12.6
IADB basket of currencies	0.032	4.3	1.01

We have not utilized derivative financial instruments.

As of December 31, 2009, 2010 and 2011, we had no short-term indebtedness outstanding, other than the current portion of long-term debt.

Interest Rate Risk

As of December 31, 2009, 2010 and 2011, R$2,193.1 million, or 33.4%, R$2,529.4 million, or 30.6%, and R$2,537.1 million or 29.5%, respectively, of our total debt outstanding balance denominated in reais was based on variable rates of interest based on the UPR, which is equivalent to the TR. In addition, as of December 31, 2009, 2010 and 2011, R$1,132.4 million, or 17.3%, R$2,064.7 million, or 25.0%, and R$1,882.3 million or 21.9%, respectively, of our total debt denominated in *reais* was subject to interest rates based on the CDI. As of December 31, 2009, 2010 and 2011, R$659.4 million, R$579.2 million and R$747.3 million, respectively, of our foreign-currency denominated debt was based on the IADB and the IBRD variable rates of interest, which are determined based on the cost of funding of these multilateral organizations in each period.

As of December 31, 2009, 2010 and 2011, we did not have any derivative contracts outstanding which limited exposure to changes in the UPR or the CDI or in the IADB or IBRD variable rates. However, we are obliged by law to invest our excess cash with financial institutions controlled by the Brazilian government. We invest these excess funds, which totaled R$671.1 million, R$1,852.6 million and R$2,027.0 million as of December 31, 2009, 2010 and 2011, respectively, mainly in short-term instruments. As a result, our exposure to Brazilian interest rate risk is partially limited by our *real*-denominated floating interest time deposits investments, which generally earn interest based on the CDI. In addition to our exposure with respect to existing indebtedness, we may become exposed to interest rate volatility with respect to indebtedness incurred in the future.

We estimate that we would have suffered a loss over periods of one year, respectively, of up to R$65.6 million, R$82.6 million and R$86.0 million if a hypothetical instantaneous and unfavorable change of 100 basis points in the interest rates applicable to financial liabilities as of December 31, 2009, 2010 and 2011, respectively, had occurred. Consistent with these estimates, a hypothetical instantaneous and unfavorable 100 basis points change in these interest rates would have resulted in losses of approximately R$655.8 million, R$826.5 million and R$859.6 million as of December 31, 2009, 2010 and 2011, respectively. This sensitivity analysis is based on the assumption of an unfavorable 100 basis point movement of the interest rates applicable to each homogeneous category of financial liabilities and sustained over a period of one year or nine months, as applicable, and that such movement may or may not affect interest rates applicable to any other homogenous category of financial liabilities.

A homogeneous category is defined according to the currency in which financial liabilities are denominated and assumes the same interest rate movement within each homogeneous category (*i.e.*, U.S. dollars). As a result, our interest rate risk sensitivity model may overstate the effect of interest rate fluctuation on these financial instruments, as consistently unfavorable movements of all interest rates are unlikely.

The tables below provide information about our interest rate-sensitive instruments. For variable interest rate debt, the rate presented is the weighted average rate calculated as of December 31, 2011. For the foreign currency denominated obligations, these amounts have been converted at the selling rates as of December 31, 2011 and do not represent amounts which may actually be payable with respect to such obligations on the dates indicated.

	As of December 31, 2011 Expected maturity date					
	2012	**2013**	**2014**	**After 2015**	**Total**	**Average annual interest rate**
	(in millions, except percentages)					
Assets						
	2,031.1	-	-	-	2,031.1	

Cash equivalents denominated in *reais*						
Total assets	**2,031.1**	**-**	-	-	**2,031.1**	
Liabilities						
Long-term debt						
Floating rate, denominated in *reais* indexed by TR or UPR	474.0	505.3	207.0	1,350.8	2,537.1	9.9%
Floating rate, denominated in *reais* indexed by TJLP	82.8	69.7	86.2	647.4	886.1	2.3%
Floating rate, denominated in *reais* indexed by IPCA	7.3	11.7	11.7	157.0	187.7	16.5%
Floating rate, denominated in *reais* indexed by CDI	876.6	470.8	270.0	264.9	1,882.3	12.4%
Fixed rate, denominated in reais	-	-	-	49.6	49.6	
Floating rate, denominated in U.S. dollars	118.4	111.3	111.3	804.0	1,145.0	2.8%
Fixed rate, denominated in Yen	59.8	53.2	53.2	799.2	965.4	2.4%
Fixed rate, denominated in U.S. dollars	11.1	5.2	5.2	921.6	943.1	3.4%
Total long-term debt	**1,630.0**	**1,227.2**	**744.6**	**4,994.5**	**8,596.3**	**7.4%**

The percentage of our indebtedness subject to fixed and floating interest rate is as follows:

	As of December 31,		
	2009	**2010**	**2011**
Floating rate debt:			
Denominated in U.S. dollars	16.1%	11.7%	13.3%
Denominated in *reais*	73.4%	72.8%	63.9%
Fixed rate debt:			
Denominated in *reais*	-	-	0.6%
Denominated in Yen	6.2%	5.3%	11.2%
Denominated in U.S. dollars	4.3%	10.2%	11.0%
Total	**100.0%**	**100.0%**	**100.0%**

C. Research and Development, Patents and Licenses, Etc.

Our policy is to invest continually in the modernization of equipment and in the technology needed to identify, evaluate and improve our provision of basic sanitation services while promoting environmental protection and maintaining our competitiveness and profitability. Our research and development activity is divided into committees according to strategy and complexity. In 2009, 2010 and 2011, we invested R$3.8 million, R$3.8 million and R$3.2 million, respectively, in research and development.

In order to further develop our expansion plans, we created a new division for research, technology development and innovation in May 2010. Among other initiatives, the new division is responsible for: monitoring technological trends, defining our research projects portfolio, obtaining funding from development agencies, developing an intellectual property protection policy and establishing cooperation agreements for the development of researches that are of our interest. The new division will also enable us to increase the quality of our procedural processes and technology portfolio.

With respect to our partnership with the State of São Paulo Research Foundation (*Fundação de Amparo à Pesquisa do Estado de São Paulo*), or the FAPESP, to develop and support research projects involving researchers from graduate schools, the State of São Paulo and our employees, in 2010 we approved 12 projects related to: (i) the development of technology related to the use of filtering membranes in water and sewage treatment, (ii) alternatives for the treatment, mud disposal and use in water and sewage treatment stations, (iii) new technologies for the implementation, operation and maintenance of water distribution and sewage collection systems, (iv) new technologies for improvements in unitary operations processes, (v) water quality monitoring, (vi) energetics efficiency and (vii) sanitary economy.

Intellectual Property

Trademarks

We have secured registration of our logo and composite trademark at the Brazilian Institute of Industrial Property (Instituto Nacional da Propriedade Industrial), or the INPI. We have registered with the INPI the following trademarks: “Sabesp,” “Sabesp Soluções Ambientais,” “Projeto Tietê,” “Programa Córrego Limpo,” “Programa Onda Limpa,” “Prol – Programa de Reciclagem do Óleo De Fritura,” “Revista DAE,” “Ligação Sabesp,” “Clubinho Sabesp,” “Cauã,” “Denis

"Gabi," "Gotucho," "Gota Borralheira," "Dr. Gastão," "Iara," "Ratantan," "Sayuri" And "SuperH20." Cauã, Denis, Gabi, Gotu Gota Borralheira, Dr. Gastão, Iara, Sayuri and Ratantan are some of the characters of our children's club (Clubinho SABESP), which is a tool for environmental education directed to children through our website).

We have also filed applications with the INPI for registration of the following trademarks: "Parque Da Integração," "Programa de Recuperação Ambiental," "Signos" (Sistema De Informação Geográfica No Saneamento), "Scorpion," "Semana do Meio Ambiente Sabesp," "Pura-Programa de Uso Racional da Água," "Agente da Gente – Sabesp na Comunidade," "Sabesp Inteligência Ambiental," "Aqualog – Tecnologia Sabesp," "Eficaz," "Água De Reúso Sabesp," "Água Sabesp Aquífero Guarani," "Água Sabesp Estação Cantareira," "Contrato de Fidelização Sabesp," "Esgotos não Domésticos Sabesp," and the following character of the Clubinho SABESP: "Cadu."

Patents

We have a patent granted by the INPI for a constructive device in a building hydraulic simulator used for didactic purposes. We have also filed patent requests for the following additional devices:

§ a water consumption measurement unit;

§ a biofilter odor control unit;

§ a device for the removal of supernatants in the treatment of sewage; and

§ a mobile device for the calibration of hydrometers.

We are currently awaiting responses to our patent requests from the INPI. While the requests are under consideration, we are granted the exclusive right to use these devices.

Software

We have adopted an internal policy that provides for an active and effective audit and prevention of unauthorized software. We have acquired the software licenses for all our workstations.

We have also developed certain computer programs for management and control of water and sewage treatment facilities, as well as for third party services management, called "AQUALOG (Control Water Treatment Plants)," "SGL (Bid Management System), "SCORPION (software to Operacional Control)", "Electronic Price Quotation" (*Cotação Eletrônica de Preços*), "PREGÃO SABESP ONLINE", "SISDOC – Sistema de Controle de Documentos", "Sistema de análise do comportamento metrológico de hidrômetros", "Modelo padronizado de Laudo técnico-MPLT," and "SGH" - hydrometry management system (*Sistema de Gestão de Hidrometria*). We have also secured registration of these programs at the INPI.

AQUALOG is a Brazilian software designed to monitor water treatment through the employment of artificial intelligence. In 2001, we completed the first rendering of services based on the AQUALOG software to a third party with the automatization of a water treatment plant in the city of Jaguará do Sul, State of Santa Catarina. We have entered into an agreement to license the software to Sanesul, in the state of Mato Grosso do Sul and to Teuto's drugs factory, in the city of Anapólis, state of Goiás. We currently have a temporary license for the AQUALOG software and are awaiting its final registration with the INPI.

SGL is an electronic price quotation system that allows us to view and control all bid and acquisition proceedings in real time.

Domain Names

We own the domain names described below which have been registered with the relevant entity in Brazil, Regristro.br:

§ www.sabesp.com.br;

§ www.corregolimpo.com.br;

- www.projetotiete.com.br;
- www.revistadae.com.br;
- blogdasabesp.com.br;
- blogsabesp.com.br;
- sustentabilidadesabesp.com.br;
- clubinhosabesp.com.br; and
- superh2o.com.br.

D. Trend Information

Several factors may affect our future results of operations, liquidity and capital resources, including:

- the interests of our controlling shareholder;

§ regulations issued by the ARSESP regarding several aspects of our business, including with respect to our ability to adjust our tariffs;

§ Brazilian economic conditions;

§ meteorological conditions;

§ the effects of any continued international financial turmoil that may affect liquidity in the Brazilian capital and lending markets;

§ the effects that further changes in the Basic Sanitation Law and its interpretation may have on the basic sanitation industry in Brazil and on us;

§ the effects of inflation in our results of operations;

§ the effects of fluctuations in the value of the Brazilian real and in interest rates on our net interest income;

§ the effects from the increase in tariff that occurred on September 11, 2011;

§ the renewal of our concession agreements; and

§ the formalization of agreements with certain of the municipalities we serve.

Each of these factors is described in more detail under "5.A. Operating and Financial Review and Prospects."

In addition, you should read "3.D. Risk Factors" for a discussion of the risks we face in our business operations, which could affect our business, results of operations or financial condition.

E. Off Balance Sheet Arrangements

We had no off balance sheet arrangements as of December 31, 2011.

F. Tabular Disclosure of Contractual Obligations

Our debt obligations and other contractual obligations as of December 31, 2011 were as follows:

	Less than 1 year	1-3 years	3-5 years	More than 5 years	Total
	(in millions of *reais*)				
Loans and financing	1,630.0	1,971.8	1,307.1	3,687.4	8,596.3
Estimated interest payments(1)	485.8	875.3	543.9	1,475.5	3,380.5
Operating and capital lease obligations(2)	64.1	178.9	169.6	2,599.5	3,012.1
Alto Tietê PPP	85.9	94.7	182.8	862.2	1,225.6
Pension plan contributions(3)	77.3	169.7	195.5	1,312.5	1,755.0

PAES program(4)	36.7	18.4	-	-	55.1
Purchase obligations	346.5	249.9	81.4	-	677.8
Total	**2,726.3**	**3,558.7**	**2,480.3**	**9,937.1**	**18,702.4**

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(1) Estimated interest payments on loans and financing were determined considering the interest rates as of December 31, 2011. However, our loans and financing are subject to variable interest indexation and foreign exchange fluctuations, and these estimated interest payments may differ significantly from payments actually made.

(2) Includes capital lease obligations which are collateralized by part of the billings from the provision of water and sewage services.

(3) Consists of pension plan contributions estimated for the following year.

(4) The PAES program, as set forth by Law No. 10,684, dated May 30, 2003.

We believe that we can meet the maturity schedule through a combination of funds generated by operations, the net proceeds of new issuances of debt securities in the Brazilian and international capital markets and additional borrowings from domestic and foreign lenders. Our borrowings are not affected by seasonality. For information concerning the interest rates on our indebtedness outstanding as of December 31, 2011, see Note 12 to our consolidated financial statements included elsewhere in this annual report.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

Under our bylaws and Brazilian Corporate Law, we are managed by our board of directors (*Conselho de Administração*), which currently consists of ten directors, and a board of executive officers (*Diretoria*), which currently consists of six executive officers.

As our controlling shareholder, the State has the ability to control the election of our board of directors and, therefore, our direction and future operations. Upon the election of a new State governor and any resulting change in the administration of the State, all or some of the members of our board of directors, including our chairman, have historically been replaced by designees of the new administration. Our board of directors may in turn replace some or all of the executive officers. See "Item 3.D. 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 differ from ours or from minority shareholders' interests, and which could have a material adverse effect on us."

Board of Directors

Our bylaws provide for a minimum of five and a maximum of 15 directors. The members of our board of directors are elected at a general shareholders' meeting to serve renewable two year terms. Pursuant to our bylaws, our employees have the option to elect one member of our board of directors. Currently, our employees have not elected a director. In addition, pursuant to Brazilian Corporate Law, at least one member of the board of directors of mixed capital companies, such as us, must be appointed by the minority shareholders. Finally, according to the *Novo Mercado* rules, at least 20.0% of the board of directors must be comprised of independent members.

The current members of our board of directors were elected in the general shareholders' meeting held on April 23, 2012. The tenure of the directors will end upon the election of the new members at the general shareholders' meeting to be held in April 2014. Currently, we have three directors considered independent under the *Novo Mercado* rules.

Our board of directors ordinarily meets once a month or when called by a majority of the directors or the chairman. Its responsibilities include the establishment of policy and general orientation of our business, and the appointment and supervision of our executive officers.

The following are the names, ages, positions, dates of election and brief biographical descriptions of the current members of our board of directors:

Director	Age	Position	Date Elected
Edson de Oliveira Giriboni	59	Chairman	April 23, 2012
Sidney Estanislau Beraldo	61	Director	April 23, 2012
Dilma Seli Pena	62	Director	April 23, 2012
Walter Tesch	68	Director	April 23, 2012
Alberto Goldman	74	Director	April 23, 2012
Heraldo Gilberto de Oliveira	47	Independent Director*	April 23, 2012
Jerônimo Antunes	56	Independent Director*	April 23, 2012
Reinaldo Guerreiro	59	Independent Director*	April 23, 2012
Andrea Sandro Calabi	66	Director	April 23, 2012

Alexander Bialer	65	Independent Director*	April 23, 2012

* These directors comply with the independence requirements established by the *Novo Mercado* rules.

Edson Giriboni. Mr. Giriboni has been the chairman of our board of directors since April 2011. Mr. Giriboni holds a degree in civil engineering from the *Escola Politécnica* of the *Universidade de São Paulo*, a degree in business administration from the *Associação Educacional de Itapetininga*, and post-graduate degrees from the *Universidade de Campinas* and the *Universidade Federal de Minas Gerais*. Mr. Giriboni has been the Secretary of Sanitation and Water Resources of the State of São Paulo since January 2011. He is also a State Deputy in São Paulo. Mr. Giriboni was the general manager of Fepasa and the vice-mayor of the city of Itapetininga where he also worked at the Municipal Department of Works and Public Utilities, and subsequently, in the Municipal Department of Industry and Development.

Sidney de Oliveira Beraldo. Mr. Beraldo has been a member of our board of directors since April 2011. Mr. Beraldo holds a degree in biological sciences and a degree in business administration and a post-graduate degree in business administration. He has been the Chief of Staff of the São Paulo State Government Office since January 2011. Mr. Beraldo started his career in politics as city councilman in 1977 and was the mayor of the city São João da Boa Vista between 1983 and 1988. In 1994, Mr. Beraldo was elected State Deputy, position he held until March 2011 after several re-elections. He was the president of the Legislative Assembly from 2003 to 2005, president of the State Council of the political party PSDB from 2005 to 2006, head of the Public Management Department until April 2010 and the general coordinator of Governor Geraldo Alckmin's campaign.

Dilma Seli Pena. Ms. Pena has been a member of our board of directors since January 2007 and our Chief Executive Officer since January 2011. She holds a master's degree in public administration from FGV and a degree in geography from the *Universidade de Brasília*. In 1976, she began her career as a public servant working for the Research Institute of Applied Economics (*Instituto de Pesquisa Econômica Aplicada*), or IPEA. She was director of the sanitation division of the Urban Policy Secretariat of the Ministry of Planning Office (*Secretaria de Política de Saneamento Urbano*), director of the strategic investments division of the Ministry of Planning (*Investimentos Estratégicos do Ministério de Planejamento*) and director of the Brazilian National Water Agency (*Agência Nacional de Águas*). She was a deputy secretary of the Economics and Planning Secretariat of the São Paulo state government (*Secretaria de Economia e Planejamento do Estado de São Paulo*) and an effective member of the Environmental Board of the Industry Federation of the State of São Paulo (*Conselho Ambiental da Federação das Indústrias do Estado de São Paulo*). From 2007 to 2011, she was responsible for the State Secretariat of Sanitation and Water Resources (formerly known as the State Secretariat of Sanitation and Energy) and has been the chairperson of the board of directors of EMAE and CESP, companies owned by the State of São Paulo. She has authored a number of articles, texts and books in the areas of sanitation, water resources and planning.

Walter Tesch. Mr. Tesch has been a member of our board of directors since April 2011. He holds a degree in sociology from the University of Uruguay and a master's degree in social sciences from the Pontifical Catholic University of Peru. Mr. Tesch has worked in Peru, Venezuela and several Latin American countries. Between 2005 and 2008, Mr. Tesch was the head of the administrative district of Parelheiros, a water source region in the city of São Paulo, and until 2010 he was the deputy Executive Secretary of the "Water Defense" ("*Defesa das Águas*") operation, an agreement between the São Paulo Municipal and State governments. Mr. Tesch is also the author of books on cooperativism and water sources in the city of São Paulo.

Alberto Goldman. Mr. Goldman has been a member of our board of directors since April 2011. Mr. Goldman holds a degree in civil engineering from the *Escola Politécnica* of the *Universidade de São Paulo*. Mr. Goldman was vice-governor of São Paulo from January 2007 to March 2010 and governor of São Paulo from April 2010 to December 2010. He was a member of our board of directors from April 2009 to March 2010. He was also the State Secretary of Development (currently, Development, Science and Technology State Department) from January 2007 to February 2009, State Deputy for two terms and Federal Deputy for six terms. Mr. Goldman was the president of the Budget Mixed Committee in 2000 and *rapporteur* of the General Telecommunications Law. He was the Special Secretary of State of the Program Coordination in 1987 and of the Administration Coordination between 1988 and 1990. Mr. Goldman was the Minister of Transportation from 1992 to 1994.

Heraldo Gilberto de Oliveira. Mr. Oliveira has been a member of our board of directors since November 2009. He holds a degree in accounting and a degree in business administration. He also holds a master's degree in controllership and accounting from the *Faculdade de Economia, Administração e Contabilidade* of the *Universidade de São Paulo*, or FEA-USP. Mr. de Oliveira is a professor of Capital Markets and Investor Relations in the post-graduation and MBA courses at the *Fundação Instituto de Pesquisas Contábeis, Atuariais e Financeiras*, or FIPECAFI. Mr. Oliveira is a partner at *FCO Consultores Associados* and works as an accounting and financial expert consultant. He worked for ten years as an independent accountant. Mr. Oliveira was a member of the board of directors and the coordinator of the audit committee *of* Banco Nossa Caixa S.A. from 2007 to August 2009 and since September 2009 has been the coordinator of the audit committee of Banco Industrial e Comercial S.A. – BICBANCO. He has been a director of the *Instituto de Executivos em Finanças of São Paulo* since September 2009.

Jerônimo Antunes. Mr. Antunes has been a member of our board of directors since April 2008. He holds a master's and Ph.D. degree in controllership and accounting from the *Universidade de São Paulo* and holds a degree in business administration and accounting. He has been a certified independent accountant and consultant in accountability and corporate finance since 1977. He has been a professor at FEA-USP since 1999, a professor of several MBA courses, at FIPECAFI since 2000, at FEA-USP, since 2000, and at *FIA – Fundação Instituto de Administração* since 2006. He was a professor at the *Universidade Federal do Ceará* from 2000 to 2005 and in several other institutions. He was a director of FIPECAFI, from 2000 to 2007. He was a board member and director of IBRACON from 1998 to 2006 and a director of *Associação Nacional dos Executivos de Finanças, Administração e Contabilidade*, or ANEFAC, from 1994 to 2000.

Reinaldo Guerreiro. Mr. Guerreiro has been a member of our board of directors since January 2007. He holds a Ph.D. in accounting and controllership, a master's degree in accounting and controllership and a bachelor's degree in accounting sciences, all of them from FEA-USP. Currently, he is both professor and Director at FEA-USP. He has also authored the books "*A meta da empresa, seu alcance sem mistérios,*" "*Gestão do lucro,*" "*Estruturação de sistemas de custos para gestão de rentabilidade,*" and co-autored "*Controladoria uma abordagem de gestão econômica*" and "*Contabilidade gerencial.*" He is a researcher at CNPQ and has published various scientific articles In domestic and international magazines. He is a specialized consultant in financial management. He has worked on various projects in the areas of financial management, costs, budget and IT in a variety of companies. Other than for us, Mr. Guerreiro does not serve on the board of directors of any other public companies.

Andrea Sandro Calabi. Mr. Calabi has been a member of our board of directors since April 2011. Mr. Calabi holds a degree in economics from FEA-USP, a master's degree in economics from the *Instituto de Economia e Pesquisa* of the *Universidade de São Paulo* (IPE-USP), a master's of arts and Ph.D. in economics from the University of California, Berkeley. Mr. Calabi has been the State Secretary of the São Paulo State Treasury since January 2011. He was the São Paulo State Secretary of Economics and Planning from January 2003 to February 2005. Mr. Calabi was the president of the BNDES, FINAME (the Special Agency of Industrial Financing), BNDESPAR (the holding company of BNDES) from July 1999 to February 2000 and also of Banco do Brasil, from January to July to 1999. He was Executive Secretary of the Ministry of Planning and president of the Institute of Applied Economics Research of Ministry of Planning, or IPEA, from 1995 to 1996, Secretary of the National Treasury of the Ministry of Finance from 1986 to 1988, General Secretary of the Department of Planning of Presidency and Chief Executive Officer of the IPEA from 1985 to 1986. Mr. Calabi was a member and chairman of several boards of directors and currently is a member of the board of directors of CESP, Higher Economics Council of FIESP, Institute of Cancer, Centro Cultural, FFM – Faculty of Medicine Foundation – USP, Albert Einstein Hospital and of the IBGC – Brazilian Institute of Corporate Governance.

Alexander Bialer. Mr. Bialer has been a member of our board of directors since April 2003. He holds a degree in mechanical engineering from *Instituto Tecnológico da Aeronáutica—ITA* and a specialization degree in systems administration from the FGV. He is a member of the board of directors of ROMI, AVIANCATACA, Andritz Hydro Inepar and pacific Rubiales energy. In addition, Mr. Bialer was Director of Business Development of GE in Brazil and Latin America, from which he retired in 2002. He also collaborated with AVON, Máquinas Piratininga and ASEA.

Board of Executive Officers

Our board of executive officers is composed of six executive officers appointed by our board of directors for renewable two year terms. Our executive officers are responsible for all matters concerning our day-to-day management and operations. Members of our board of executive officers have individual responsibilities established by our board of directors and our bylaws.

The following are the names, ages, positions, dates of election and brief biographical descriptions of our board of executive officers:

Executive Officer	Age	Position	Date Elected
Dilma Seli Pena	62	Chief Executive Officer	June 2, 2011
Manuelito Pereira Magalhães Junior	44	Corporate Management Officer	June 2, 2011
Rui de Britto Álvares Affonso	54	Chief Financial Officer and Investor Relations Officer	June 2, 2011

Paulo Massato Yoshimoto	59	Metropolitan Region Officer	June 2, 2011
Luiz Paulo de Almeida Neto	55	Regional Systems Officer	June 2, 2011
João Baptista Comparani	55	Technology, Enterprises and Environment Officer	September 15, 2011

Environment Officer

Dilma Seli Pena. See above "—Board of Directors."

Manuelito Pereira Magalhães Júnior. Mr. Magalhães has been our Corporate Management Officer since January 2011. Mr. Magalhães was a member of our board of directors from January 2007 to February 2011. He holds a degree in economic sciences and a master's degree in economic sciences from the *Instituto de Economia, Universidade Estadual de Campinas*. He was a member of the board of directors of the Companhia de Engenharia de Tráfego de São Paulo, of the COHAB and, of the Empresa de Tecnologia de Informação e Comunicação de São Paulo. He was a parliamentary advisor in the Federal Senate. From 1998 to 2002, he was the special advisor of the Minister of Health. From 2005 to 2006 he was the ombudsman of the National Supplementary Health Agency, or ANS. From 2005 to 2006, he was the deputy secretary of the Planning Secretariat and the secretary of Planning of the Municipality of São Paulo. He was also the technical advisor, the secretary of finance and the director of the Department of Advisory, Planning and Management in the municipality of Campinas, State of São Paulo.

Rui de Britto Álvares Affonso. Mr. Affonso has been our Chief Financial Officer and Investor Relations Officer since July 2003. Mr. Affonso holds a Ph.D. and a master's degree in economics from the *Universidade Estadual de Campinas*, or UNICAMP, and a degree in economics from the *Universidade de São Paulo*. He has been a professor at UNICAMP since 1986, a professor at FEA-USP from 1983 to 1989, and a director of public economy at *Fundação do Desenvolvimento Administrativo* from 1994 to 2003. He also represented Brazil on the board of the Forum of Federations (a non governmental entity based in Canada) from 2000 to 2006. Mr. Affonso has also held several positions at the State government.

Paulo Massato Yoshimoto. Mr. Yoshimoto has been our metropolitan officer since February 2004. He holds a degree in civil engineering from the *Escola de Engenharia de Lins*. Mr. Yoshimoto joined us in 1983, and has held the positions of executive assistant to the operations office and head of the water production and maintenance and metropolitan planning departments. Mr. Yoshimoto has also held the position of senior planning professional at *Empresa Metropolitana de Planejamento*, from 1975 to 1983.

Luiz Paulo de Almeida Neto. Mr. Almeida Neto has been our regional systems officer since January 2011. He holds a degree in civil engineering from the *Escola Politécnica* of the *Universidade de São Paulo*, a business administration degree from *Fundação Educacional Votuporanga/SP* and a post-graduate degree in sanitary engineering from *Faculdade de Saúde Pública* of the *Universidade de São Paulo*. Mr. Almeida joined us in 1979 and has worked with us as head of the Baixo Tietê Business Unit responsible for the management of areas located in the hydrographic basins of Baixo Tietê, Tietê-Batalha, São José dos Dourados and Turvo Grande. Mr. Almeida Neto has authored several articles.

João Baptista Comparini. Mr. Comparini has been our Technology, Enterprises and Environment Officer since September 2011 He holds a degree in civil engineering with especialization in public health engineering, and holds a masters and a doctorate degree all from the *Escola Politécnica* of the *Universidade de São Paulo*. He holds an MBA in management from *Fundação Getúlio Vargas*. He joined us in 1980 and holding different positions. From 2002 until September 2011, he was the head of the business unit of *Pardo e Grade*, responsible for the management of services in the municipalities of Sapucaí-Mirim/Grande, Mogi-Guaçu, Pardo and Baixo Pardo/Grande.
Mr. Comparini is author of several articles and co-author of the book *Biossólidos na Agricultura*.

B. Compensation

Pursuant to Brazilian Corporate Law, our shareholders are responsible for establishing the aggregate amount of compensation we pay to the members of our board of directors, members of our fiscal committee and our executive officers. According to Instruction No. 480 issued by CVM, we have to periodically disclose certain information on the aggregate compensation such as averages and fringe benefits.

For the year ended December 31, 2011, the aggregate compensation, including benefits in kind granted that we paid to members of our board of directors, board of executive officers and fiscal committee for services in all capacities was R$3.9 million.

The tables below sets forth the break down of the total compensation received by our directors and members of our board of executive officers and fiscal committee and other data related to their compensation for the periods indicated:

	Year ended December 31,		
	2009	**2010**	**2011**
Total compensation per administrative body (in thousands of R$):			
Board of directors	1,225	1,215	1,240
Board of executive officers	2,200	2,231	2,442
Fiscal committee	231	229	217
Total amount of compensation (in thousands of R$)	**3,656**	**3,675**	**3,899**
Number of members:			
Board of directors	13	10	10
Board of executive officers	6	6	6
Fiscal committee	5	6	5
Fixed annual compensation			
Salary (in thousands of R$):			
Board of directors	918	903	853
Board of executive officers	1,283	1,304	1,265
Fiscal committee	231	229	217
Direct and indirect benefits (in thousands of R$):			
Board of directors	-	-	-
Board of executive officers	406	394	495
Fiscal committee	-	-	-
Variable compensation			
Bonus (in thousands of R$):			
Board of directors	307	312	387
Board of executive officers	511	533	681
Fiscal committee	-	-	-
Maximum amount of compensation (in thousands of R$):			
Board of directors	108	148	169
Board of executive officers	396	477	444
Fiscal committee	38	38	46
Minimum amount of compensation (in thousands of R$):			
Board of directors	41	100	81
Board of executive officers	303	324	276
Fiscal committee	38	38	46
Average amount compensation (in thousands of R$):			
Board of directors	94	113	128
Board of executive officers	367	372	407
Fiscal committee	46	38	46

Profit Sharing and Pension Plans

We have established a pension and benefit fund (*Fundação SABESP de Seguridade Social*), or SABESPREV, to provide our employees with retirement and pension benefits. This pension plan provides benefit payments to former employees and their families. Both we and our employees make contributions to the pension plan. We are also required to pay supplemental pension payments relating to the employment contract of certain employees prior to the creation of SABESPREV. Our total contributions to the pension plan totaled R$12.9 million, R$13.8 million and R$8.9 million in 2009, 2010 and 2011, respectively. Based on independent actuarial reports, as of December 31, 2011, our obligation under these plans totaled R$1,638.2 million. For further information on our pension plans see Note 16 to our consolidated financial statements.

Beginning in 2008, payments under the profit-sharing plan were based both on general goals that evaluate us as a whole and on other goals that evaluate the performance our different business units. Payments are proportionally reduced annually if the goals are not completely achieved.

We recorded profit-sharing expenses of R$53.4 million, R$52.6 million and R$56.6 million in 2009, 2010 and 2011, respectively. We do not have a stock-option plan for our employees.

C. Board Practices

The members of our board of directors are elected at a general shareholders' meeting to serve renewable two-year terms. Our board of directors ordinarily meets once a month or when called by a majority of the directors or the chairman. See "Item 6.A. Directors and Senior Management—Board of Directors."

Our board of executive officers is composed of six executive officers appointed by our board of directors for renewable two-year terms. Meetings of our board of executive officers are held weekly in the case of ordinary meetings or when called by the chief executive officer in the case of special or extraordinary meetings. See "Item 6.A. Directors and Senior Management—Board of Executive Officers."

None of our directors and/or executive officers is a party to an employment contract providing for benefits upon termination of employment. Those directors and officers who are also our employees will remain as our employees after their tenure as directors and/or officers, in this case, maintaining all benefits granted to our employees.

Fiscal Committee (*Conselho Fiscal*)

Our fiscal committee, which is established on a permanent basis, consists of a minimum of three and a maximum of five members and generally meets once a month consists of four members and four alternates. Furthermore, each member has its respective alternate. The current members of our fiscal committee were elected in the shareholders' meeting held on April 23, 2012. Their tenure will end in 2013, depending on when they were elected. The primary responsibility of the fiscal committee, which is independent from management and from the external auditors appointed by our board of directors, is to review our consolidated financial statements and report on them to our shareholders.

The following are the names, ages, position, date of election and brief biographical descriptions of the current and alternate members of our fiscal committee:

Fiscal Committee Members	Age	Position	Date Elected
José Antonio Xavier	51	Member	April 23, 2012
Humberto Macedo Puccinelli	54	Member	April 23, 2012
Horácio José Ferragino	61	Member	April 23, 2012
Alexandre Luiz Oliveira de Toledo	52	Member	April 23, 2012
Tomás Bruginski de Paula	50	Alternate	April 23, 2012
Antônio Cláudio Zeituni	41	Alternate	April 23, 2012
José Rubens Gozzo Pereira	64	Alternate	April 23, 2012
Joaldir Reynaldo Machado	63	Alternate	April 23, 2012

José Antonio Xavier. Mr. Xavier has been a member of our fiscal committee since April 2011. He holds a degree in economy and a post-graduate degree in governmental controllership from the *Pontifícia Universidade Católica de São Paulo* (PUC-SP). Mr. Xavier was an auditor of the State Treasury from 1993 to 1998 and the Technical Director of the State Treasury since 1998. He was a member of the Fiscal Committee at BANESCARD, CESP and CDHU.

Humberto Macedo Puccinelli. Mr. Puccinelli has been a member of our fiscal committee since April 2011. Mr. Puccinelli holds a degree in economics from the *Pontifícia Universidade Católica de São Paulo* (PUC-SP). He worked at the Department of Planning from 1985 to 1995, at the Health State Department as secretary assistant from 1995 to1996, at the State Treasury from 1996 to 2002, and at the Planning Department as secretary assistant in 2003.

Since January 2004 he has been the Technical Assistant of the State Treasury.

Horácio José Ferragino. Mr. Ferragino was elected to our fiscal committee on April 23, 2012. He holds a degree in accounting from the *Faculdades Integradas Santo Antônio – FISA-SP*. He worked in the public sector for the State Fund for School Buildings (*FECE – Fundo Estadual de Construções Escolares*) from 1970 to 1976, for the School Building Company from 1976 to 1988 (*CONESP – Cia de Construções Escolares*), for the Educational Development Foundation (*FDE – Fundação para o Desenvolvimento da Educação* from 1988 – 1995) and *Casa Civil e Secretaria de Gestão Pública* (1995 – 2012), where he coordinated projects involving public purchase policies. He currently works as Project Coordinator for the Department of Planning and Regional Development.

Alexandre Luiz de Oliveira Toledo. Mr. Toledo has been a member of our fiscal committee since April 2010. He holds a degree in law from the *Universidade de São Paulo*. Mr. Toledo has worked with financial institutions for 20 years, especially in capital markets transactions, defending minority shareholders. He has worked in the legal departments of Bradesco de Investimentos and Schahin Cury S.A. Mr. Toledo is and has been a member of various fiscal committees and board of directors including CELG, COPEL, CST and Plascar.

Tomás Bruginski de Paula. Mr. de Paula has been an alternate member of our fiscal committee since April 2006. He holds a degree and a master's degree in economics from UNICAMP. He has been a Professor at the Economics Department of *Pontifícia Universidade Católica – PUC* since 1986. He has been an executive officer at Companhia Paulista de Parcerias since 2004 and Companhia Paulista de Securitização since 2009. Mr. de Paula has worked as a consultant for several entities, including the Economic Committee for Latin America (CEPAL), the United Nations Development Program (PNUD), the Brazilian Institute of Municipal Administration (IBAM), the Brazilian School of Public and Business Administration of FGV (EBAPE/FGV), the State System Data Analysis Foundation (SEADE), and the Brazilian Electricity Agency in the infrastructure and public policy financing areas. He is also a member of the fiscal committee of the Nossa Caixa Desenvolvimento and a member of the Board of Directos of DERSA. Mr. de Paula was also a member of the fiscal committee of the São Paulo Company of Electric Power Transmission.

Antônio Cláudio Zeituni. Mr. Zeituni has been an alternate member of our fiscal committee since April 2011. He holds a degree in law from the *Pontifícia Universidade Católica de São Paulo*. Mr. Zeituni has worked with banking, civil and administrative law. He has also worked in several law firms, including Oliveira de Toledo & Advogados Associados where he is currently a partner.

José Rubens Gozzo Pereira. Mr. Pereira has been an alternate member of our fiscal committee since April 2010. He holds a degree in economics from *Universidade Mackenzie*, a graduate degree from FGV and attended international studies extension programs at the Universities of London and Paris. He has been responsible for the Funding department of the Finance Secretariat since 1989. Mr. Pereira held positions in the public sector in the DAEE, where he was responsible for the Budget and Financing area; he was an executive officer at *Companhia de Engenharia de Tráfego – CET*, and in the International Cooperation department of *Companhia Energetica de Silo Paulo – CESP*. Mr. Pereira has been the coordinator for the Funding Department of the Silo Paulo State Government in the Finance Secretariat since 1991.

Joaldir Reinaldo Machado. Mr. Machado has been an alternate member of our fiscal committee since April 2010. He holds a degree in economics from *Universidade de São Paulo*. Mr. Machado has been an employee of SEADE since 1979. He has also held several other management positions, including management advisor to *Empresa Metropolitana de Planejamento – EMPLASA*, financial executive of the Finance Department of our Company, chief of staff of the Environment Secretariat and chief of staff and head of department of the SEADE Foundation. Mr. Machado is currently the chief of staff of the Economy and Planning Secretariat of the São Paulo State Government.

Audit Committee

Our bylaws provide for an audit committee to be comprised of three board members, who will cumulatively comply with the requirements of (i) independence, (ii) technical expertise, and (iii) identifying and complying with applicable exemptions in accordance with the United States Securities and Exchange Commission, or the SEC, and New York Stock Exchange, or NYSE, rules. The members are appointed by the board of directors.

The audit committee is responsible for assisting and advising the board of directors in its responsibilities to ensure the quality, transparency and integrity of our published financial information. To this end, the audit committee supervises all matters relating to accounting, internal controls and the internal and independent audit functions. The audit committee and its members have no decision making powers or executive functions.

The minimum availability required from each member of the audit committee is thirty hours per month. Under our bylaws, the members shall exercise their roles for the same period as their corresponding term of office, or until otherwise resolved by the general shareholders' meeting or by resolution of the board of directors.

The following are the names, positions and dates of election of the members of our audit committee:

Director	Position	Date Elected
Jerônimo Antunes	Coordinator and Financial Expert	April 26, 2012
Reinaldo Guerreiro	Member	April 26, 2012
Heraldo Gilberto de Oliveira	Member	April 26, 2012

Regulatory Affairs Committee

Our bylaws provide for a regulatory issues committee to be comprised by the our Chief Executive Officer, Chief Financial Officer and Investor Relations Officer, Metropolitan Officer, and Regional System Officer. The regulatory affairs committee is responsible for defining our regulatory directives, strategies and guidelines and coordinating our regulatory affairs department, subject to the guidelines defined by our board of directors.

The Chief Executive Officer acts as chairman of our regulatory affairs committee and is responsible for proposing its internal regulations to be approved by the committee. Pursuant our bylaws, the head of regulation shall be the executive secretary of the committee.

Under our bylaws, the resolutions of our regulatory affairs committee shall be binding and our executive boards shall be entitled to implement them in the scope of its jurisdiction. Meetings of our regulatory affairs committee are held at least once a month, if ordinary, and when extraordinary can be called by any of our committee's members.

Corporate Governance Practices

The significant differences between our corporate governance practices and NYSE standards can be found on our website, www.sabesp.com.br, at the following location: Investors Relations – Corporate Governance – SABESP and NYSE Standards. The information found at this website is not incorporated by reference into this document.

D. Employees

As of December 31, 2011, we had 14,896 full-time employees. In 2011, we had an average of 918 trainees and 506 apprentices (*aprendizes*), as defined by federal Law No. 10,097, dated December 19, 2000.

The following table sets forth the number of our full-time employees by main category of activity and geographic location as of the dates indicated:

	As of December 31,		
	2009	**2010**	**2011**
Number of employees by category of activity:			
Projects and operations	9,763	10,092	9,782
Administration	2,574	2,527	2,501
Finance	490	477	454
Marketing	2,276	2,234	2,159
Number of employees by corporate division:			
Head office	1,541	1,496	1,475
São Paulo metropolitan region	7,055	7,135	6,861
Regional Systems	6,507	6,699	6,560
Total number of employees	**15,103**	**15,330**	**14,896**

The average tenure of our employees is approximately 17 years. We also outsource certain services such as maintenance, delivery of water and sewage bills, meter reading, catering and security. We believe that our relations with our employees are generally satisfactory.

Approximately 70% of all our employees are members of unions. The five main unions that represent our employees are the Sindicato dos Trabalhadores em Água, Esgoto e Meio Ambiente de São Paulo - SINTAEMA, Sindicato dos Trabalhadores da Região Urbana de Santos, São Vicente, Santos, Região Metropolitana de Santos, Litoral Sul e Vale Ribeira - SINTIUS, the Sindicato dos Engenheiros do Estado de São Paulo - SEESP, the Sindicato dos Advogados de São Paulo - SASP and the Sindicato dos Técnicos Industriais de Nível Médio(2ºGrau) no Estado de São Paulo - SINTEC. As a result of the 2010 collective bargaining discussions, wages were temporarily increased by 5.05%. The unions filed a claim with the Labor Court seeking to, among other requests, increase wages by 1.5%, increase the salary base over which the annual profit distribution is calculated, increase payment of overtime in 100% and increase additional payment of working night hours from 20% to 50%. The Labor Court decided in favor of the unions and we appealed from the decision. We are still waiting for the decision on our appeal. Any unfavorable decision by the Labor Court will result in an increase in expenses with personnel. Our most recent collective bargaining agreement, entered into in 2011: (i) increased wages by 6.39% (which corresponds to the adjustment for inflation for the period) plus a real gain of 1.51%, (ii) established an employment guarantee for 98% of our employees, (iii) increased the number of days permitted under maternity leave from 120 to 180 days and (iv) increased meal vouchers by 10.07%, among other provisions.

We have experienced the following strikes in the last seven years, none of which interrupted the essential services that we provide: a two-day strike in June 2005, a one-day strike in May 2006, a four-day strike in June 2008, a three-day strike in May 2009, an eight-day strike in May 2010 and a one day strike in 2011. Under Brazilian law, our non-administrative employees are considered “essential employees” and, therefore, are limited in their right to strike.

E. Share Ownership

As of April 23, 2012, the members of the board of directors and the executive officers owned an aggregate of 2,612 common shares. The members of our board of directors and our executive officers, on an individual basis and as a group, beneficially own less than 0.1% of our common shares. See "Item 7.A. Major Shareholder" for more information. As of the same date, none of our directors and executive officers owned any stock option plans.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholder

Our outstanding capital stock as of December 31, 2011, consisted of 227,836,623 common shares, without par value. Under our bylaws and the State laws, the State is required to own at least one-half plus one of our outstanding common shares. All of our shareholders, including the State, have the same voting rights.

The following table sets forth ownership information for each of our shareholders that beneficially owned 5.0% or more of our common shares and for our officers and directors, individually and as a group, as of April 23, 2012.

	Common shares	
	Shares	**%**
State of São Paulo	114,508,086	50.3%
Directors and executive officers of SABESP	2,612	Less than 0.1%
Others	113,325,925	49.7%
Total[(1)]	**227,836,623**	**100.0%**

(1) As of April 23, 2012, 24.8% of our outstanding common shares were held by 2,977 registered shareholders in Brazil.

As of April 20, 2012, 24.9% of our outstanding common shares were held in the United States, in the form of ADSs. According to the ADS depositary's records, which contain information regarding the ownership of our ADSs, there were, on March 30, 2012, 38 record holders of ADSs in the United States.

B. Related Party Transactions

Transactions with the State of São Paulo

We have entered into extensive transactions with the State, which is our controlling shareholder, and we expect to continue to do so. The State is our largest customer. It owns some of the facilities that we use in our business, it is one of the governmental entities that regulate our business, and it has assisted us in obtaining financing on favorable terms.

Many of our transactions with the State reflect policies of the State that depend on decisions of elected officials or public servants, and are accordingly subject to change. Among the practices that could change are those described below concerning the provision of State guarantees, and the terms on which we use State-owned reservoirs.

Rending Services

We provide water and sewage services to the federal government, state and municipal governments and government entities in the ordinary course of our business. Sales of water and sewage services to the State, including State entities, totaled R$358.3 million in 2009, R$383.5 million in 2010 and R$405.0 million in 2011. Our accounts receivable from the State for water supply and sewage services totaled R$169.5 million, R$157.2 million and R$145.4 million, as of December 31, 2009, 2010 and 2011, respectively. In addition, as required by law, we invest our cash and cash equivalents with government financial institutions in short-term securities.

Payment of Pensions

Pursuant to a law enacted by the State, certain former employees of some State-owned companies that provided services to us in the past and later merged to form our Company acquired a legal right to receive supplemental pension benefit payments. These rights are referred to as "Plan G0." These amounts are paid by us, on behalf of the State, and are claimed by us as reimbursements from the State, as primary obligor. In 2009, 2010 and 2011, we made payments to former employees of R$108.0 million, R$118.4 million and R$124.4 million, respectively, in respect of Plan G0. The State made reimbursements in 2009, 2010 and 2011 in the amount of R$83.7 million, R$59.0 million and R$60.4 million, respectively.

Agreements with the State

In September 1997, we and the State entered into a memorandum of understanding providing that we would, in effect, apply dividends we declared that were otherwise payable to the State to offset accounts receivable in connection with the provision of water and sewage services to the State and its controlled entities.

On December 11, 2001, we entered into an agreement with the State and the DAEE. Pursuant to this agreement, the State acknowledged and agreed, subject to an audit by a State appointed auditor, to pay us amounts it owed to us in respect of:

§ water and sewage services we provided to governmental agencies, State owned autonomous entities and foundations through December 1, 2001, and that was not offset in accordance with the September 1997 memorandum of understanding, in the total amount of R$358.2 million. This amount was renegotiated and included in the second amendment to this agreement discussed below; and

§ supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State owned companies which merged to form our Company; as we did not reach an agreement regarding these amounts, a joint inquiry has commenced in order to ensure agreement between us and the State, in the total amount of R$320.6 million. This amount was renegotiated and included in the third amendment to this agreement discussed below.

The agreement provided that the DAEE would transfer to us ownership of the Taiaçupeba, Jundiaí, Biritiba, Paraitinga and Ponte Nova reservoirs (herein after referred to as "the reservoirs"), which form the Alto Tietê system, and that the fair value of these assets would reduce the amounts owed to us by the State.

Under the December 2001 agreement, in 2002, a State-owned construction company (*Companhia Paulista de Obras e Serviços*), or the CPOS, on behalf of the State, and an independent appraisal firm (*Engenharia de Avaliações*), or the ENGEVAL, on our behalf, presented their valuation reports relating to the reservoirs. Under the agreement, the arithmetic average of these appraisals is deemed the fair value of the reservoirs. The appraisals contained in these reports were in the amounts of R$335.8 million and R$341.2 million, respectively. Because we had already made investments in these reservoirs by then, the arithmetic average of the appraisals submitted to our board of directors by August 2002, R$300.9 million, was net of a percentage corresponding to these investments. Our board of directors approved the valuation reports.

Under the December 2001 agreement, for amounts due in excess of the fair value of the reservoirs, the State is to make payments in 114 consecutive monthly installments. The nominal amount owed by the State would not be indexed to inflation or earn interest if there was a delay in concluding the appraisal of fair value. The installments will be indexed on a monthly basis by the IGP M index, plus 6.0% per year, starting on the date the first installment becomes due.

On October 29, 2003, the Public Prosecution Office of the State of São Paulo (*Ministério Público do Estado de São Paulo*), on behalf of the people of the State, brought a civil public action in a Trial Court of the State of São Paulo (*12a Vara da Fazenda Pública do Estado de São Paulo*) alleging that a transfer to us of ownership of the Alto Tietê system reservoirs from the DAEE would be illegal. An injunction against the transfer of ownership of such reservoirs was granted but was later reversed. However, in October 2004, the court of first instance handed down its judgment on the civil public action and declared the agreement between us, DAEE and State of São Paulo null and void. This decision was suspended by us, and the State treasury and DAEE appealed the decision. On August 23, 2010, the appeal was denied. We have petitioned for clarification of the appeal court's decision and will seek to take the case to the Supreme Court. The effects of the appeal court's decision will be suspended until the end of the legal process. Our legal counsel has assessed the risk of loss as probable, which would prohibit the transfer of the reservoirs in payment of the accounts receivable due from the State.

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 us by the State. The commencement of payments with respect to pension amounts owed to us 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 are formalized. As discussed above, the transfer of these reservoirs is currently being disputed and we are not certain whether the transfer will be legally permitted. Under the December 2001 agreement, the first payment was to be made in July 2002.

On March 22, 2004, we and the State entered into a first amendment to the December 2001 agreement. Under this amendment, the State acknowledged that it owed R$581.8 million to us relating to unpaid accounts receivable from the State until February 29, 2004, and we acknowledged that we owed an aggregate amount of R$518.7 million to the State as dividends, in the form of interest on shareholders' equity. Accordingly, we and the State agreed to offset each other's credit up to the limit of R$404.9 million, which was an amount adjusted up to February 2004. The outstanding balance of R$176.9 million (as of February 29, 2004) of the State's consolidated debt would be paid in consecutive monthly installments from May 2005 until April 2009. These installments would be indexed according to the IPCA index, plus an interest rate of 0.5% per month. Upon the execution of the first amendment, part of the debt that the State owed to us for the use of water and sewage services through February 2004 was offset by the debt that we owed to the State as dividends, in the form of interest on shareholders' equity. The outstanding balance of R$113.8 million as dividends in the form of interest on shareholders' equity that we owed to the State was netted against accounts overdue after February 2004. The first amendment did not amend the provisions of the December 2001 agreement regarding the supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State-owned companies.

On December 28, 2007, we and the State entered into a second amendment to the December 2001 agreement, pursuant to which the State agreed to pay (i) the outstanding balance under the first amendment, in the amount of R$133.7 million (as of November 30, 2007), in 60 consecutive monthly installments, beginning on January 2, 2008, and (ii) the amount of R$236.1 million relating to part of the accounts overdue and unpaid from March 2004 through October 2007 regarding the provision of water supply and sewage collection services. As part of this amendment, we agreed to pay during the period from January through March 2008 the outstanding balance of dividends in the amount of R$400.8 million, in the form of interest on shareholders' equity, due from March 2004 through December 2006. We paid these amounts as agreed. Under the second amendment, dividends payable by us are no longer required to be applied to offset accounts receivable from the State, and as a result, we are currently unable to determine the amount, if any, of the declared dividends that the State will apply to current and future accounts receivable owed to us by the State or its entities. In addition, pursuant to the second amendment, we and the State agreed on complying with certain mutual obligations relating (i) to the improvement of payment processes and budget management procedures; (ii) the rationalization of the use of water and the amount of water and sewage bills under the responsibility of the State; (iii) the recording of government entities with accounts overdue in a delinquency system or reference file; and (iv) the possibility of interrupting water supply to these entities in case of non-payment of water and sewage bills. Finally, this second amendment did not amend the provisions of the December 2001 agreement regarding the supplemental retirement and pension benefits we paid from March 1986 through November 2001 on behalf of the State to former employees of the State-owned companies that merged to form our Company.

In 2007, we received payment installments from the State in the amount of R$326.0 million. As of December 31, 2007, our dividends payable to the State, due from 2004 through 2007, were in the amount of R$552.0 million. We are currently unable to determine the amount, if any, of the declared dividends that the State will apply to current and future accounts receivable owed to us by the State or its entities. The second amendment no longer requires that dividends be applied to offset accounts receivable from the State.

On March 26, 2008, we entered into a commitment agreement (*termo de compromisso*) with the State with the purpose of finding an alternate solution to the deadlock related to the amount owed by the State to us in connection with the supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State-owned companies which merged to form our Company. In this agreement, we and State committed to hiring specialized companies to carry out new valuations of the amounts owed to us by the State and of the reservoirs. An independent consulting firm, FIPECAFI, has been retained to resolve the disagreement and validate the amount we paid from March 1986 through November 2001 on behalf of the State to former employees of the State-owned companies that merged to form our Company, which the State has not yet agreed to reimburse us hereinafter referred to as the "Disputed Reimbursement Amount". In addition, FIPECAFI is performing, together with another independent consulting firm, a new evaluation of the reservoirs that might be transferred to us as amortization of the reimbursement payable by the State to us.

On November 17, 2008, we, the State and DAEE entered into a third amendment to the December 2001 agreement, pursuant to which the State recognized a debt balance payable to us totaling R$915.3 million, hereinafter referred to as the "Undisputed Reimbursement Amount," as adjusted based on the IPCA. We accepted on a provisional basis the reservoirs as part of the payment of the Undisputed Reimbursement Amount and offered to the State a provisional settlement, recognizing a credit totaling R$696.3 million, corresponding to the value of the reservoirs located in the Alto Tietê region. We and the State have agreed that the final offset will only be recorded when the effective transfer of the reservoirs is recorded at the Real Estate Registry. The outstanding balance of Undisputed Reimbursement Amount, amounting to R$219.0 million, is being paid by the State in 114 consecutive monthly installments, as adjusted by the annual IPCA variation, plus interest accruing at the annual rate of 6.0%. The first installment was paid in November 2008.

In addition to the Undisputed Reimbursement Amount, there is an outstanding balance relating to the Disputed Reimbursement Amount. As of December 31, 2011, the Disputed Reimbursement Amount amounted to R$1,290.7 million, but due to the uncertainty regarding the recovery of the amount our management decided not to recognize the reimbursements. See Note 8 to our consolidated financial statements as of and for the year ended December 31, 2011 regarding the Disputed Reimbursement Amount. We and the State have agreed that the dispute relating to the Disputed Reimbursement Amount will not prevent us from carrying out the commitments made in the December 2001 agreement. We are working with the State government to obtain legislative authorization to transfer the reservoirs to us.

In addition, the third amendment to the December 2001 agreement provides for the regularization of the monthly flow of benefits. While we are liable for the monthly flow of benefits to the former employees of the state-owned companies that merged to form our Company, the State shall reimburse us based on criteria identical to those applied when determining the Undisputed Reimbursement Amount. Should there be no preventive court decision, the State will assume the flow of monthly payment of benefits portion deemed as undisputed.

Finally, the third amendment to the December 2001 agreement established that the Public Attorney's Office of the State of São Paulo, or the Public Attorney's Office, would issue a revised interpretation of the calculation and eligibility criteria applicable to the Disputed Reimbursement Amount. At that time, we believed that the Public Attorney's Office would issue a revised interpretation which would have helped us bring the negotiations with the State to a conclusion. However, contrary to our expectations, the Public Attorney's Office recent interpretation of the calculation and eligibility criteria applicable to the Disputed Reimbursement Amount refuted the reimbursement of the largest portion of this amount. As of December 31, 2011, we had made a provision of R$1,512.1 million in our pension obligations accounts in respect of the Disputed Reimbursement Amount.

Even though the negotiations with the State are still progressing, we cannot assure you that we will recover the receivables related to the Disputed Reimbursement Amount.

We will not waive the receivables from the State to which we consider ourselves to be legally entitled. Accordingly, we will take all possible actions to resolve the issue at all administrative and court levels. Should this conflict persist, we will take all the necessary actions to protect our interests. On March 24, 2010, we sent to the controlling shareholder the official letter approved by our executive committee, proposing that the matter be discussed at the BM&FBOVESPA Arbitration Chamber. In June 2010, we sent a settlement proposal to the Secretary of Treasury, which was denied, and (iii) on November 9, 2010, we filed a civil lawsuit against the State of São Paulo seeking full reimbursement of the amounts paid as benefits granted by Law No. 4,819/58. Regardless of the civil lawsuit, we will continue to actively seek a settlement with the State government.

Agreement with the State and the city of São Paulo

On June 23, 2010 the State and the city of São Paulo entered into a convention (*convênio*) with the intermediation and consent of our Company and of the ARSESP pursuant to which they agreed to jointly manage the planning of and investment in the basic sanitation system of the city of São Paulo, among other things. This agreement established that the State and the city of São Paulo would enter into an agreement with us, granting us exclusive rights in the provision of water and sewage services in the city of São Paulo. In addition, the agreement established the role of the ARSESP in regulating and overseeing our activities, and established a management committee that will be responsible for planning the water and sewage services and for reviewing our investment plans. The management committee is composed of six members appointed for renewable two-year terms. The State and the city of São Paulo have the right to appoint three members each. We are permitted to participate in the meetings of the management committee, but we are not afforded any voting rights.

On June 23, 2010, we entered into a formal agreement with the State and the city of São Paulo to regulate the provision of water and sewage services in the city of São Paulo for a 30-year period, which may be extended for an additional 30-year period. Municipal Law No. 14,934/2009 authorized the city of São Paulo to enter into an agreement with us. The agreement establishes, among other things, how specific amounts of gross revenues from the services we render should be allocated (after deduction of COFINS and PASEP). This agreement requires, among other things, (i) to invest at least 13.0% of the gross revenues from sales and services we obtain from the municipality of São Paulo, net of taxes on revenues in the improvement of water and sewage infrastructure in the city of São Paulo; (ii) that our investment plan must be compatible with the activities and programs included in the sanitation plan of the

State, the sanitation plan of the city of São Paulo and, if necessary, the sanitation plan of the metropolitan region of São Paulo; and (iii) that we contribute 7.5% of the gross revenues we obtain from this agreement to the São Paulo Municipal Sanitation Fund. The investment plan under this agreement is not irrevocable and will be reviewed by our management committee every four years, especially with regards to investments to be executed in the subsequent period. In addition, the agreement provides that the ARSESP, the State agency responsible for regulating the basic sanitation industry, will ensure that the tariffs charged (a) will adequately compensate us for the services we provide and (b) can be adjusted to restore the original balance between each party's obligation and economic gain (*equilíbrio econômico-financeiro*). We currently have an investment plan in place that consider these obligations and also addresses the compatibility with the activities and programs included in the sanitation plan of the State and of the municipality of São Paulo and, if necessary, the plan of the metropolitan region of São Paulo. See "Item 4.B. Business Overview—Our Operation—Operations in the City of São Paulo and Certain Metropolitan Regions."

Dividends

We regularly pay dividends to our shareholders, including the State of São Paulo. In the past, we have withheld part of the dividends to which the State was entitled in order to offset it against our pending receivables from the State.

In accordance with our agreements with the State, we do not anticipate that we will withhold dividends to which the State was entitled in order to offset it against our pending receivables from the State in the near future.

Cash and Cash Equivalents

Our cash and cash equivalents invested with State financial institutions in short-term securities amounted to R$722.2 million, R$1,945.7 million and R$2,070.2 million, as of December 31, 2009, 2010 and 2011, respectively. Interest income from these investments totaled R$74.2 million in 2009, R$137.7 million in 2010 and R$271.8 million in 2011.

Government Guarantees of Financing

In some situations, the federal government, the State or government agencies guarantee our performance under debt- and project-related agreements.

Furthermore, the federal government has guaranteed, and the State has provided a counter-guarantee, in respect of the financial agreements we entered into with the IADB (i) in 1992 and 2000 for the total original aggregate amount of US$650.0 million related to the financing of the first and second phases of the Tietê River recovery project to reduce pollution; and (ii) in 2010 for the aggregate amount of US$600 million related to the financing of the third phase of the Tiête River project. The federal government has also guaranteed and the State of São Paulo has provided a counter-guarantee, in respect of the financial agreement we entered with the International Bank for Reconstruction and Development (IBRD) in the amount of US$100 million for the Water Source Program (Programa Mananciais).

We also entered into credit agreements with the JICA, which were guaranteed by the federal government, with counter-guarantee from the State of São Paulo, for the financing of (i) the Clean Wave Program for the Baixada Santista metropolitan region, in August 6, 2004, for an aggregate principal amount of ¥21,320 million; (ii) the second phase of the Clean Wave Program, in February 2011, for an aggregate principal amount of ¥19,169 million; (iii) the environmental improvement program in the basin of the Billings dam, as part of the New Life Program (Programa Vida Nova), in October 2010, for an aggregate principal amount of ¥6,208 million; and (iv) the Corporate Program for Water Loss Reduction, in February 2012, for an aggregate principal amount of ¥33,584 million

The State has also guaranteed a portion of our repayment obligations under loan agreements that we entered into with the federal government in 1994 through its financial agent, Banco do Brasil S.A. which totaled R$828.2 million as of December 31, 2011.

In addition, we are currently negotiating with Caixa and BNDES for additional loans to finance portions of our capital expenditure program.

For more information on the aforementioned loans, see “Item 5.B. Liquidity and Capital Resources—Capital Sources—Indebtedness Financing.”

Use of State-Owned Reservoirs

We currently use the Guarapiranga and Billings reservoirs which are owned by another company controlled by the State, based on a grant issued by the DAEE. We do not pay any fees with respect to the use of these reservoirs. We are, however, responsible for maintaining them and funding their operating costs. The State incurs no operating costs on our behalf. If these facilities were not available for our use, we would have to obtain water from more distant sources, which would be more costly.

Agreements with Lower Tariffs

We have entered into agreements with public entities, including State entities and municipalities, which manage approximately 5,700 properties. Under these agreements, these public entities pay a different tariff which is approximately 25.0% lower than the tariff that applies for the public entities that have not entered into these agreements, provided such entities implement our PURA program for the rational use of water, which includes a reduction of at least 10.0% in water consumption. These agreements are valid for a 12-month term with automatic renewal for equal periods. Pursuant to the terms of these agreements, if these entities fail to make any payment on a timely basis to us, we have the right to cancel the agreement, thereby revoking the 25.0% tariff reduction.

Personnel Assignment Agreement among Entities Related to the State Government

We have personnel assignment agreements with entities related to the State Government, under which the expenses are fully passed on and monetarily reimbursed. The expenses related to personnel assigned by us to other state government entities in 2009, 2010 and 2011 amounted to R$5.4 million, R$5.6 million and R$10.9 million, respectively.

In 2011, none of our personnel had been assigned by other entities. In 2010 and 2009, the expenses related to personnel assigned by other entities to us totaled R$0.3 million.

Services Obtained from State Government Entities

As of December 31, 2011, 2010 and 2009, we had an outstanding amount payable of R$12.1 million, R$11.4 million and R$10.4 million, respectively, for services rendered by São Paulo State government entities, including the supply of electric power by CESP.

Non-operating Assets

We lend land, free of charge, to associations, support entities, non governmental organizations and to DAEE, among others. Such non-operating assets totaled R$26.5 million, R$25.4 million and R$21.5 million as of December 31, 2009, 2010 and 2011, of which R$2.3 million was lent to DAEE, as of December 31, 2011.

Banco do Brasil

We filed a lawsuit against the Department of Finance of the State São Paulo seeking financial compensation related to the transfer of our exclusive rights in bank services. On March 27, 2007, the State of Sao Paulo sold exclusive rights in the provision of banking services administration entities directly and indirectly in favor of Banco Nossa Caixa. On May 27, 2010, the State of Sao Paulo sold them in favor of Banco do Brasil. In this lawsuit, we were pleading financial compensation for the sale of its exclusive rights, requiring a percentage of the values that the State of São Paulo received from each of the financial institutions for the services contract entered into.

On June 28, 2011, we entered into an agreement with the State of Sao Paulo for the , whereby we received the amount of R$63.4 million upon reduction, as compensation of credit held by the State, corresponding to interests on shareholders' equity in the fiscal year 2010.

Transactions with SABESPREV Pension Fund

SABESPREV is a pension fund we established to provide our employees with retirement and pension benefits. The assets of SABESPREV are independently held, but we nominate 50.0% of SABESPREV's board of directors, including the chairman of the board, who has the deciding vote pursuant to the applicable legislation. Both we and our employees make contributions to SABESPREV pension plans. We contributed R$12.9 million, R$13.8 million and R$8.9 million in 2009, 2010 and 2011, respectively. On May 29, 2001, a federal law was enacted which, among other provisions, limits the amount mixed capital companies, like us, may contribute to their pension plans. Specifically, the ordinary contributions made by us to our pension plans may not exceed the contributions made by the beneficiaries of these plans.

Our original pension plan (the Defined Benefit Plan) has an actuarial deficit. We have commenced studies to manage this deficit and have also created a new, defined contribution plan, Sabesprev Mais. Our new plan was approved by the Previc in June 2010, after which our old plan stopped accepting new members. Contributions to the new plan are also shared between plan members and Sabesp, and benefits are established based on the balance of the individual member's account when payment on his or her benefit begins. This balance consists of contributions and profitability obtained when applying resources. We intended to have members of the old plan migrate their reserves to the new plan. This migration was temporarily interrupted by a judicial order as a result of proceedings brought by representative entities for our employees and ex-employees. In October 2010, the judge presiding over the case pronounced in an interim decision that people and reserves were not allowed to migrate between the plans until a further decision was made. This decision also prevents the plan from charging contributions to account for the deficit for those who remained covered by the original plan.

Compensation of Management

The compensation paid by us to the members of our board of directors, board of executive officers and fiscal committee amounted to R$2.6 million in 2009, 2010, and 2011, and it refers to salaries and other short-term benefits to employees and management. An additional amount of R$0.8 million, R$0.8 million and R$1.1 million related to the bonus program, was accrued in 2009, 2010 and 2011.

For further information on management compensation, see "Item 6.B. Compensation."

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

See "Item 3.A. Selected Financial Data" and "Item 18. Financial Statements."

Legal Proceedings

In the ordinary course of our business, we are a party to judicial and administrative proceedings relating to civil, environmental, labor and tax matters. As of December 31, 2011, we estimated that these legal proceedings totaled R$24,152.0 million (excluding the amount of R$133.1 million related to court deposits). This amount was based on probable, possible and remote losses and on the value attributed to the lawsuit by the plaintiffs in some cases and on the economic value of the lawsuits in others. Out of the total amount of contingencies as of December 31, 2011, approximately R$2,367.2 million relate to tariff-related legal proceedings and consumers claims, approximately R$1,147.8 million relate to contractors' claims, approximately R$1,105.7 million relate to tax proceedings, approximately R$349.7 million relate to labor proceedings, approximately R$18,405.1 million relate to civil public actions related to environmental matters and approximately R$776.4 million relate to other civil matters. As of December 31, 2011, the provision for legal contingencies totaled R$1,571.8 million (excluding the amount of R$120.7 million related to court deposits), of which R$618.5 million relate to tariff-related legal proceedings and consumers claims, R$420.8 million relate to contractors' claims, R$76.4 million relate to tax proceedings, R$156.5 million relate to labor proceedings, R$121.2 million relate to civil public actions related to environmental matters and R$178.4 million relate to other civil matters.

The table below sets forth, as of December 31, 2011, our estimated contingencies with respect to legal proceedings, categorized by potential risk of loss:

	Total Value (in thousands of *reais*)
Expected probable loss	1,571,829
Expected possible loss	2,621,800
Expected remote loss	19,958,346
Total	24,151,975

The difference between the provisioned amount and the total amount of the contingencies derives from the methodology for establishing our provisions. This methodology takes into account: (i) the probability of loss of each lawsuit, based on the alleged facts, the claim based on the factual circumstances vis-à-vis the law, as well as prevailing precedents in similar cases; and (ii) the calculation of the provisioned amounts, which requires significant judgment and in certain circumstances, given the nature of the claim, we are unable to estimate with accuracy our liability exposure. In these cases, we have taken into account the value attributed to the lawsuits by the plaintiff and legal opinions of counsel in charge of each lawsuit. Once the methodology is applied, as a general rule, we make the provisions only for the lawsuits that are considered as probable losses.

We cannot give any assurances either as to the sufficiency of the provisioned amount to cover the contingencies or as to the total amount of potential liabilities that we may incur or penalties that may be imposed. We may not obtain a favorable outcome in the administrative or court proceedings to which we are a party. In addition, the total amount of the contingencies, based on the value attributed to the lawsuit by the plaintiff, may not correspond to the economic value of the lawsuits, which may be substantially higher than the total estimated amount of contingencies. If the economic outcome of these lawsuits is higher than the amount attributed to the lawsuit by the plaintiff or, in the event the total amount of our provisions are not sufficient to pay the contingencies due, we could incur greater costs than those that were originally estimated. If these costs are significant, our results of operations and financial condition could be negatively affected. See "Item 3.D. Risk Factors—Risks Relating to Our Business—Any substantial monetary judgment against us in legal proceedings may have a material adverse effect on us."

Civil Public Actions Related to Environmental Matters

We have been sued by the Public Prosecution Office of the State of São Paulo (*Ministério Público do Estado de São Paulo*), by some municipalities and by some non-governmental organizations in a number of environmental civil public actions: (i) seeking that we cease releasing raw sewage into certain local water courses; (ii) in some cases seeking remedies for environmental damages, which have not yet been specified and evaluated by the court's technical experts; and (iii) seeking to require us to install and operate sewage treatment facilities in the locations referred to in the civil public actions. In each case, we are subject to daily fines for non-compliance. In our response to these lawsuits we emphasize that the installation and operation of sewage treatment facilities in the locations referred to in the civil public actions is included in our investment plan and that the immediate cessation of the release of raw sewage into the relevant local water courses would hinder us from collecting sewage, a primary necessity, in those locations, causing even more damage to the environment and public health. There have already been unfavorable judicial decisions against us. The effects may include: (i) investment in works or services not considered by the long-term investment plan; (ii) early execution of works or services that were considered for execution in future years in the long-term investment plan; (iii) payments related to environmental indemnification; and (iv) a negative impact on our image in national and international markets and in public bodies.

Although we are not able to predict the final outcome of these lawsuits, we believe that the outcome, if unfavorable to us, may have a material adverse effect on us.

The civil public lawsuits related to environmental matters to which we are party include the following:

- The Public Prosecution Office of the State of São Paulo has brought a civil public action requesting remedies due to environmental damage caused by the release of sludge from the Rio Grande water treatment facilities into certain receiving waters and the Billings reservoir and seeking the immediate cessation of this activity and the implementation of an environmental recovery project. The Trial Court ruled in our favor, and there was a subsequent appeal against this decision. In May 2006, the appellate court ruled against us and ordered us to cease the release of sludge within a year from the final ruling. The court also determined that the environmental recovery must be carried out within two years of the date of the ruling, under the penalty of a daily fine of R$10,000 to compensate for environmental damage. We appealed from this decision and the court decided against us in a final decision. We are currently studying a proposal to be made to the Public Prosecution Office of the State of São Paulo on how to implement the environmental recovery we have been imposed. As of December 31, 2011, we had provisioned R$1.2 million for the effects of this lawsuit.

- A public civil action filed by the Public Prosecution Office of the State of São Paulo against us and the Cotia Mayor's Office seeking individual and joint adverse judgments against the defendants and requesting: (i) the

permanent cessation of the release of untreated water effluents into the Cotia River or its tributaries, subject to a daily fine in the case of non-compliance; (ii) the treatment of sewage prior to its release into the Cotia River, under the penalty of a daily fine in the event of non-compliance; (iii) the full restoration of soil, of surface and underground water bodies and of vegetation to their original condition, under the penalty of a daily fine in the event of non-compliance; (iv) the payment of compensation for environmental damage caused to soil, water sources and underground and surface water bodies that cannot be recovered. The appellate court rendered decisions favorable to us with respect to items (i), (iii) and (iv) mentioned above. According to evaluations by the court's technical expert, as of October 17, 2006, compensation for environmental damages was R$826.8 thousand or R$5.8 million if damage caused to the neighboring Cotia River is included. This amount is under discussion, and its approval is subject to a final decision by the court of first instance. Our legal counsel assessed the risk of loss as probable. In December 2011, the court's technical expert's evaluation for the compensation was adjusted to R$11.6 million. The lawsuit is currently being enforced against us. We are in negotiation with the Public Prosecution Office of the State of São Paulo to settle this lawsuit.

- In 2003, the Piracicaba Civil Entities Coordination Board filed a public civil action against us, the ANA and the Government of the State of São Paulo, seeking remedy for damage caused by the use of the Piracicaba, Jundiaí and Capivari river basins to supply the São Paulo metropolitan region through the Cantareira Water System for nearly 30 years. The value attributed to the claim was R$11.4 billion on December 10, 2003, and later adjusted to R$17.2 billion as of December 31, 2011. The lawsuit was dismissed on July 8, 2011, but the Piracicaba Civil Entities Coordination Board filed a motion for the clarification of a certain aspect of that decision. Having the motion rejected, the plaintiff may file an appeal to the Superior Courts. So far no value has been set for the damages alleged. Our legal counsel assessed the risk of loss as remote. No provision has been made for this lawsuit.

- The Public Prosecution Office of the State of São Paulo has filed a public civil action against us, AES Eletropaulo, DAEE, CETESB and the State Secretariat of Treasury seeking a joint condemnation for alleged environmental damage caused by the reversal of the Pinheiros River into the Billings Dam. A Trial Court found the defendants guilty and, based on an expert's report which estimated the amount of damages, ruled that the defendants jointly pay R$284.5 million in damages. As of December 31, 2011, the amount of damages totaled R$618.3 million, after monetary adjustment. We, DAEE, AES Eletropaulo, CETESB and the State Treasury Department have filed an appeal against the ruling at the appellate court. The appellate court ruled in our favor, and the plaintiff appealed from this decision. We are currently awaiting the decision on the plaintiff's appeal. Our legal counsel assessed the risk of loss as remote. No provision has been made for this lawsuit.

- The Public Prosecution Office of the State of São Paulo has filed a civil public action against us seeking (i) that we cease releasing untreated sewage into receiving waters and into the soil; (ii) that we implement a sewage system in the municipality of Vargem Grande Paulista and the necessary infrastructure for the sewage treatment; and (iii) indemnification for irreversible damages caused to the environment and public health, subject to daily fines. The trial court ruled partially against us, and we appealed unsuccessfully. We have filed appeals for the Superior Courts. Our legal counsel assessed the risk of loss as probable. The value attributed to the lawsuit was R$3.0 million as of November 20, 2007, and later adjusted to R$3.8 million as of December 31, 2011.

- The Public Prosecution Office of the State of São Paulo filed a civil public action against us and the Piracaia Mayor's Office seeking that we cease to release untreated residential sewage in the Atibaia River or be subject to specific performance or a daily fine. The value attributed to the lawsuit was R$3.5 million as of July 11, 1996, and later adjusted to R$100 thousand, which was updated to R$262 thousand as of December 31, 2011. This lawsuit is in its initial stage, pending judgment from the trial court. Our legal counsel assessed the risk of loss as possible. No provision has been made for this lawsuit.

- The Public Prosecution Office of the State of São Paulo filed a civil public action against us seeking that we (i) cease to release untreated sewage effluents into the Capivari river in the municipality of Campos do Jordão within 540 days from the filing of the lawsuit, subject to a daily fine of R$100,000; and (ii) fully restore the environmental damage or indemnify the State for such damages if restoration is not viable. The court of first instance ruled against us, and we appealed. The appellate court also ruled against us, but reduced the daily fine to R$10,000. We have appealed the appellate court's ruling and are currently waiting for a ruling on our appeal. Our legal counsel assessed the risk of loss as probable. We have entered into a settlement with the Public Prosecution Office of the São Paulo on July 11, 2011 agreeing to build a sewage treatment station by December 31, 2013. As compensation for the environmental damage, we have agreed to recover 10 (ten)

hectares of the damaged area in Campos do Jordão, planting approximately 16,667 trees, of which 39% should be of exotic species for public exhibition at certain blocks of Avenue Emílio Ribas, at Capivari. We also agreed to expand the sewage system of that municipality and to create a center for environmental education.

§ On April 12, 2005, the Federal Public Prosecution Office and the Federal Government sued us and the Santos Mayor's Office requesting (i) the full restoration of the area where the outlet pipes were built to its original condition, with appropriate technical safeguards, and the conservation of the remaining trees; (ii) the maintenance of the area in a condition that is adequate for its use for the population; (iii) that an environmental license be obtained before any modification to the sewage outlet pipes, with the requirement that the license and an obligatory environmental impact study and report (*Estudo Prévio de Impacto Ambiental e Relatório de Impacto Ambiental*, or EIA-RIMA, be submitted for approval to the appropriate federal authorities; and (iv) the restoration of the area to the condition it was in prior to the construction of the sewage outlet pipe platform, provided this is determined to be feasible pursuant to the EIA-RIMA. The trial court ruled in our favor, but the Federal Public Prosecution Office and the Federal Government filed an appeal against that decision. We have submitted additional evidence for consideration, and we are waiting for the decision of the Regional Federal Court. Our legal counsel has assessed the risk of loss as possible. The value attributed to the lawsuit was R$2.1 million as of December 31, 2011. No provision has been made for this lawsuit.

§ On October 19, 2009, the Public Prosecution Office of the State of São Paulo filed a civil public action against us and the municipality of Itatiba seeking that we (i) cease releasing untreated sewage in Itatiba or be subject to a daily fine of R$10,000; (ii) fully restore within one year the soil, the surface and underground water bodies and vegetation to their original condition, or be subject to a daily fine of R$10,000 in the event of non compliance; (iii) indemnify the State for damages when restoration is not viable; and (iv) indemnify the State in an amount not less than R$2.0 million for moral damages. This lawsuit is in its initial stage and is pending judgment from the trial court. As of December 31, 2011, the value attributed to this lawsuit was R$31.4 thousand. Our legal counsel assessed the risk of loss as possible. No provision has been made for this lawsuit.

§ On August 8, 2008, the Public Prosecution Office of the State of São Paulo won a civil public action against us requiring us, within a maximum of three years, to treat all domestic sewage in Águas de Santa Bárbara before releasing it into any waterway, or be subject to a daily fine of R$1,000, as from August 8, 2008 for a maximum period of 18 months. We appealed and were waiting the appeal court's judgment until we entered entered into a settlement with the Prosecution Office of the State of São Paulo on August 05, 2011. Through this settlement, we agreed to create a treatment facility for the domestic sewage of Águas de Santa Bárbara until October 2012, and also to abstain from releasing any non-treated domestic sewage into a waterway in that area.

§ A civil public action was brought against us by the Public Prosecution Office of the State of São Paulo. We appealed an unfavorable decision of the trial court, and the appeal court ruled against us, requiring us (i) to cease to release any untreated sewage into the river system in the Guareí region, or be subject to a fine of R$150,000 for each violation; (ii) to invest as necessary in the municipality of Guareí's water treatment and sewage system so as to complete within 180 days all works necessary for sewage treatment, or be subject to a daily fine of R$100,000; (iii) to pay an indemnity in respect of all damage caused to the environment and to clean up any such damage in settlement of the judgment. The judgment was not clear as to the fines imposed and this led to an appeal, which the court refused in May 2010. After the appeal court ruled against us, we applied to have this lawsuit heard by the State of São Paulo Court of Special and Extraordinary Measures (*Recursos Especial e Extraordinário pelo Tribunal de Justiça do Estado de São Paulo*), and that court is currently considering whether to hear the case. Our legal counsel assessed the risk of loss as probable. As of December 31, 2011, the value attributed to this lawsuit was R$38.4 million, based on the settlement offered by the State Public Prosecution Office in July 2010, and we have recorded provisions in this amount as of that date.

§ The Public Prosecution Office of the State of São Paulo filed a civil public action against us, requiring us (i) to cease to release any untreated sewage from the Araça pre-treatment plant (*Estação de Pré Condicionamento*), or EPC, into the São Sebastião canal without obtaining the necessary environmental licenses, or be subject to a daily fine of R$100,000; (ii) to obtain and maintain the necessary environmental license to operate the Araça EPC, or be subject to a daily fine of R$100,000; (iii) to release into the São Sebastião canal only domestic sewage that complies with legal guidelines; (iv) to comply with all of the technical requirements set out in the environmental license, as well as the requirements specified following inspections by the CETESB; and (v) to pay an indemnity of R$50.0 million for environmental damage. The preliminary judgment was deferred, and we were required (i) to present to the court within six months the environmental license for the Araça EPC, or be subject to a daily fine of R$100,000, and (ii) to present to the court within 30 days a contract with a company to carry out an independent technical study with monthly reporting to monitor and collect samples from the areas of São Sebastião canal where there are underwater

outlets from the Araça EPC, as well as from the beaches and mangroves within 8 km to the north of south of the Araça EPC. The sediment samples from the mangroves were required to be analyzed for the existence of fecal coliforms as well as water quality. This lawsuit is in its initial stage and is pending judgment from the court of first instance. Our legal counsel has assessed the risk of loss as possible. The value attributed to the lawsuit as of December 31, 2011 was R$123.4 million. No provision has been made for this lawsuit.

- The municipality of Águas de São Pedro filed a civil public action against us on September 14, 2004, with a request for summary judgment or the imposition of a daily fine. This lawsuit aims to require us to undertake works and services necessary to remove the direct discharge of sewage beside the green areas and the Pantanal source and lake that are located close to Rua dos Pinheiros, in the *Bairro Jardim Iporanga*district of the municipality of Águas de São Pedro. It also aims to require us to pay indemnities for alleged damage caused to the environment, to health and to citizen's property. On June 26, 2006, the court of first instance ruled that the claim was without merit. However, on September 22, 2009, the appeals court ruled that the claim was proven and granted an injunction, ordering us to comply with the requirement to clean up the environmental damage within 180 days in satisfaction of the judgment, and imposing a daily fine of R$5,000. We appealed from this decision, and the court decided against us. We filed another appeal from this decision and are currently awaiting its decision. Our legal counsel has assessed the risk of loss as probable. The value attributed to this lawsuit as of December 31, 2011 was R$2 million, and we have recorded provisions in this amount as of that date. Currently, we are awaiting the response from the State of São Paulo Court of Special and Extraordinary Measures (*Recursos Especial e Extraordinário pelo Tribunal de Justiça do Estado de São Paulo*) in relation to this lawsuit.

- The Public Prosecution Office of the State of São Paulo filed a civil public action against us for the indemnification on environmental damages and for us to cease the discharge of untreated sewage into the Alegre river in the area of the municipality of Paraguaçu Paulista. The first instance judge has ruled against us so that we (i) cease the discharge of untreated sewage into Alegre river; (ii) to invest as necessary in that municipality's water treatment and sewage system; and (iii) pay indemnities for alleged damage caused to the environment, which the court arbitrated at R$168.9 million. The court has also imposed a daily fine in case of disobedience of item (i) and (ii) above. We appealed from this decision, and the court decided against us. We then entered into a settlement with the Public Prosecution Office of the State of São Paulo, having agreed to pay R$34 million as indemnity for environmental damages and invest R$8.7 million within 54 months on the water treatment and sewage system. The deadlines and planning for the performance of the agreement have not yet been settled. Our legal counsel assessed the risk of loss as probable. As of December 31, 2011, we provisioned R$43.7 million for this matter.

- The municipality of Atibaia filed a civil public action against us on August 2010, for the indemnification on environmental and urban damages related to flood that took place in December 2009 and January 2010 and for us to take preventive steps to avoid new damages related to similar events. The first instance judge has granted the municipality of Atibaia an injunction ordering us to perform emergency repairs around the area of the Atibaia river, or be subject to a daily fine of R$50,000. We appealed from that decision, and the injunction was suspended by the second instance court. We currently await the decision of the superior courts on the injunction. We still await a final judgment to resolve all matters of the lawsuit. The estimated amount for this lawsuit is R$ 1.9 million. Our legal counsel assessed the risk of loss as possible and no provision was made for this lawsuit.

We are currently involved in other environmental lawsuits and administrative proceedings against the release of untreated sewage in the municipalities, which have been evaluated as probable and possible losses. The amounts provisioned may not always represent the final amount to be paid as compensation for the alleged damages, in view of the current status of the lawsuits and since our management cannot reasonably estimate the amounts of future disbursements. As of December 31, 2011, the total amount provisioned was R$121.2 million.

Labor Proceedings

We are party to labor proceedings, mainly regarding unpaid overtime, health and safety conditions in the workplace, among others. We make provisions for part or the entire amounts involved in the proceedings. For those cases in which the probability of loss is assessed as probable, we provision the full amounts being discussed.

As of December 31, 2011, we were party to approximately 5,432 labor proceedings and one public civil action filed by some of our current and former employees. Some of these lawsuits seek to negotiate certain benefits granted by Law No. 4,819 of August 26, 1958. Our position in these lawsuits is that the State government, and not us, should be responsible for the payments due to the plaintiffs. In the public civil action filed against us and the State Treasury, a temporary injunction was granted in the trial court requiring us to pay the benefits set forth in Law No. 4,819/58 to all the plaintiffs. A trial court ruled on April 5, 2005, granting the relief sought under this proceeding and confirming the temporary injunction requiring us to continue to pay the benefits. We have appealed this decision. There are currently other pending individual lawsuits discussing the same claims, and up to the date of this report neither we nor the State government had reached an agreement as to the indemnification amounts related to these proceedings.

In order to continue to seek reimbursement of the amounts related to the payment of retirement benefits and pensions paid by us that our management understands is in fact owed by the State government, we have taken the following measures: (i) on March 24, 2010, we sent a letter to our controlling shareholder in an attempt to start an arbitration proceeding before the BM&FBOVESPA arbitration chamber, (ii) In June 2010, we sent a settlement proposal to the Secretary of Treasury, which was denied, and (iii) on November 9, 2010, we filed a civil lawsuit against the State of São Paulo seeking full reimbursement of the amounts paid as benefits granted by Law No. 4,819/58 and we are waiting on the court's decision. Regardless of the civil lawsuit, we will continue to actively seek a settlement with the State government.

Among the mentioned labor proceedings, as of December 31, 2011, we were party to two collective lawsuits brought by the syndicate of the workers of the water and sewage systems and environment of the State of São Paulo (SINTAEMA). The first relates to the scheduling of the workers and we had a ruling against us in the amount of approximately R$62.6 million. This lawsuit in currently under enforcement calculations. A second lawsuit filed by that syndicate relates to the increase in 1.5% of our salary base for 2010/2011, as well as overtime adjustments. The court has ruled against us and we have filed an appeal to the superior labor court, where the appeal is currently under review. The approximated amount in dispute in this lawsuit is R$11.8 million as of December 31, 2011, with a probable risk of loss.

As of December 31, 2011, the total amount in controversy in the labor proceedings was R$301.6 million for risks considered as probable and possible losses. We have established a provision of R$156.5 million as of December 31, 2011 for these contingencies, including the lawsuits described in the preceding paragraphs, based on calculations made by our legal and human resources departments.

Tax Proceedings

Our tax proceedings and our contingency reserves for tax proceedings refer mainly to tax collection suits resulting from different interpretations by us and the competent government authority with respect to the applicable law. The tax proceedings to which we are party include the following:

- We are challenging the city of São Paulo's taxation of the use of public areas for the installation of water and sewage mains for the provision of public sanitation services. The tax was originally established by municipal decree No. 38,139/99 and later replaced by municipal decree No. 40,532/2001 and finally by the municipal Law No. 13,614/2003. On February 22, 2000, we filed a writ of mandamus requesting an injunction to challenge this tax. This first lawsuit covers the taxation before the enactment of municipal Law No. 13,614/2003. The trial court ruled partially in our favor, by prohibiting the requirement to pay the tax provided for in this law, and the appellate court confirmed that the tax was not due. The city of São Paulo appealed this decision, and a final decision is pending. On April 20, 2004, we filed a writ of mandamus requesting temporary injunction against the collection of this tax based on challenges to Law No. 13,614/2003. The court granted this injunction. The São Paulo city government appealed this decision, and an appellate court decision is still pending. We cannot estimate the potential increase in our expenses should we have to pay this tax for the use of public areas for the installation of water and sewage mains for the provision of public sanitation services should we be required to pay such tax since 1999. We have not provisioned for any type of potential expense deriving from this municipal tax.

- The municipality of São Paulo has notified us of alleged infractions on the payment of Brazilian Service Tax (*Imposto Sobre Serviço*), or ISS. This charge is related to the enactment of municipal Law No. 13,476/2002, before which we were exempted from such charge. The municipality is charging the amount of approximately

R$223.9 million in charges and penalties. We filed a writ of mandamus against the administrative decision that imposed those charges. The trial court originally granted a preliminary injunction in our favor in the writ of mandamus, suspending the levy of the tax, but later ruled against us. In July 2005, we filed an appeal to maintain the injunction previously granted, which was denied in January 2012. We filed a motion to clarify items in this decision, which is under the review of the court. On the same matter, we filed a lawsuit confronting the basis for the charge, challenging Law No. 13,476/2002. We have been granted an injunction within this lawsuit that suspended the levy of the tax until the final judgment from the court. We are currently waiting for a final decision on this matter. The risk of loss has been considered as possible and we have not provisioned for any type of potential expense deriving from this municipal tax.

- We proposed to carry-over losses from previous years to offset an income tax liability of approximately R$56.1 million and a social contribution tax liability of approximately R$8.7 million. These amounts refer to the period between January and April 2003. In 2005, the Federal Revenue Service denied the set-off of approximately R$11.2 million related to income tax liability and R$0.7 million related to social contribution tax liability, totaling R$11.9 million, and allowed us to compensate the remaining portion. We appealed this decision, and our request was partially granted. As of December 31, 2011, we recorded a provision of R$1.1 million as a probable loss.

- In 2006, the Federal Revenue Service concluded that, for the year 2001, we had an income tax liability and social contribution tax liability totaling R$277.0 million (R$379.3 million, as adjusted as of December 31, 2011) and initiated administrative collection proceedings against us. We filed an administrative objection to this collection proceeding. Based on the opinion of our legal counsel, the risk of loss is remote with respect to approximately 90.0% of this amount and a possible risk of loss with respect to the remaining 10.0%.

- In 2008, the Federal Revenue Service denied six requests for compensation to offset income tax and social contribution tax liabilities. We proposed to offset income tax and social contribution tax paid in excess against our tax liability. The amount involved in these proceedings was R$44.7 million as of December 31, 2011. Based on the opinion of our internal legal counsel, the risk of loss is possible and no amount was provisioned for this proceeding.

- In November 2004, we filed a writ of mandamus against the municipality of Bragança Paulista regarding the imposition of a new tax for the use of public areas for the installation of water and sewage mains for the provision of public sanitation services. On February 16, 2005, we were granted a temporary injunction suspending the imposition of this tax and preventing the municipality from collecting any current or future amounts due in respect of this tax until a ruling is rendered by the trial court. In June 2005, the trial court ruled in our favor by confirming the injunction. In July 2005, the municipality of Bragança Paulista filed an appeal to the São Paulo appellate court, which was denied. Although the municipality may take additional judicial steps, it is probable that their attempts will be unsuccessful.

- We proposed to carry-over losses from the years 1997 and 1998 to offset an income tax liability of approximately R$41 million. This amount refers to the period between July and September 2002. The Federal Revenue Service denied the set-off and we appealed this decision. Based on the opinion of our internal legal counsel, the risk of loss is possible and no amount was provisioned for this proceeding.

- On June 23, 2010, we have entered into an agreement with the municipality of São Paulo for public water supply and sewage services. As part of this settlement, certain tax collections between the parties were settled amicably. As of December 31, 2011, the total amount related to tax collection proceedings that remained outstanding from the municipality of São Paulo was R$58.2 million, of which we provisioned R$27.7 million as a probable loss.

We cannot predict the outcome of any of these lawsuits, nor can we assure you that, in the event of an adverse decision, we will be able to pass on to our customers any increase in our deductions from gross revenue, operating expenses or other expenses. See Item 3.D. Risk Factors - Risks Relating to Our Business - Any substantial monetary judgment against us in legal proceedings may have a material adverse effect on us."

Condemnation Proceedings

We are party to a significant number of condemnation proceedings arising from the partial or total expropriation or use of private property for water mains, sewer lines and facilities. Under Brazilian law, the State or the relevant municipality is entitled to condemn private property to the extent required for the construction, development or improvement of water and sewage systems operated by us. However, we are required to provide compensation to affected property owners based upon appraised fair market values. Although we generally provide compensation to property owners on the basis of negotiated settlements, we are a party to many lawsuits related to compensation awards.

As of December 31, 2011, the future disbursement was estimated at R$448.6 million, as to all proceedings regarding expropriation and easements. These payments are made over the years, according to each court order or settlement. After making each payment, we will obtain the title to the respective real property which will be recorded as an asset belonging to us after being expropriated. We have not provisioned any amounts with regard to these proceedings.

Concession-Related Legal Proceedings

In December 1997, the municipality of Santos enacted a statute expropriating our water and sewage systems located in Santos. We filed a writ of mandamus requesting a temporary injunction against the expropriation, which was denied by the trial court. This decision was subsequently reversed by the appellate court, which then issued a temporary injunction suspending the effectiveness of the statute. By August 2, 2002, both the trial and appellate courts had ruled in our favor, but we are currently waiting for a final decision.

On December 20, 2000, we brought an action against the municipality of Santos for payments due under the concession agreement. Both parties appealed the decision of the courts of first and second instance, and we are currently awaiting the decision of the higher appeal court. We continue to render water and sewage collection services in the municipality of Santos.

On March 25, 2005, the municipality of Itapira approved a decree revoking our concession contract. In addition, a municipal law was enacted revoking an earlier law authorizing the municipality to enter into the contract with us. The municipality of Itapira has further filed a repossession lawsuit seeking to repossess all of the reversible assets, rights, and privileges transferred to us in connection with water and sewage collection services, and has obtained an injunction which was later confirmed by an appellate court decision. We appealed this decision but we later decided to waive this appeal and filed a compensation lawsuit against the municipality of Itapira.

The municipality of Tuiuti has filed a lawsuit seeking to recognize the inexistence of any judicial or legal grounds for us to provide water and sewage collection services in the municipality of Tuiuti, and to confirm the legality of the expropriation of these services by the municipality. We filed an answer to the lawsuit requesting that the trial court (i) confirm the existence of a legal relationship between us and the municipality of Tuiuti; and (ii) award damages for the expropriation of our assets. The trial court ruled against us but awarded us an indemnity of R$541.0 thousand, to be updated since March 2006. Both parties appealed this decision, and the court decided partially in our favor increasing the amount related to damages to R$1.1 million. We are not currently operating in the municipality of Tuiuti.

The municipality of Cajobi has filed a repossession lawsuit. This lawsuit requests the repossession of water and sewage collection services due to the termination of the concession agreement on November 13, 2006, and an indemnity for all amounts paid to us for water and sewage collection services after November 2006, as well as payments for the use of all the reversible assets, rights and privileges transferred to us in the concession agreement. The municipality has been rendering the water and sewage collection services since May 29, 2007, based on a judgment by the court of first instance. The amounts involved in this lawsuit are still being evaluated in the judicial proceedings.

The municipality of Araçoiaba da Serra has filed a repossession lawsuit requesting the repossession of water and sewage collection services due to the termination of the concession agreement entered into with us and an indemnity for all amounts paid to us for water and sewage collection services after the termination on September 23, 2006, as well as payment for the use of all the reversible assets, rights and privileges transferred to us in the concession agreement. A temporary injunction was granted by the appellate court in favor of the municipality of Araçoiaba da Serra and confirmed by the superior courts. The first instance court has ruled in favor of the municipality in their requests, to which we filed an appeal currently under the review of the trial court.

We have filed a lawsuit to collect indemnities from the municipalities of Diadema e Mauá. These indemnities result from the unilateral termination by these municipalities of the concession contracts entered with us in 1995. We have invested in the construction of water and sewage collection systems in these municipalities to render the contracted services. As a result of the termination of these concession agreements, the municipalities started to directly render water and sewage collection services

With respect to the collection suit against the municipality of Diadema, in October 2009, the trial court ruled in our favor. The municipality appealed from the decision to the appellate court, and the appellate court decision is still pending. 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, formerly known as the State Secretariat for Sanitation and Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*). This memorandum establishes our agreement to conclude negotiations and settle all outstanding amounts and stayed the collection proceedings we had filed against the municipality of Diadema. In 2011, the municipality of Diadema agreed with us to develop a share infrastructure for the provision of water and sewage services through a mixed-capital company called Companhia de Água e Esgoto de Diadema, or CAED. The amount owned to us by that municipality would be returned to us through capital participation in CAED, through the assignment of 49.9% shares of the new company to us.

With respect to the collection suit against the municipality of Mauá, the trial court ruled in our favor, ordering the municipality to pay us R$153.2 million as compensation for our losses. The municipality appealed this decision to the appellate court, which upheld the trial court's decision in August 2008. The municipality appealed to the Superior Court, which have denied the appeal making the decision in our favor final. We are currently pursuing to collect the amount owed.

We have recorded the indemnities to be received from the municipality of Diadema as non-current assets representing long-term receivables. As of December 31, 2011, this amount totaled R$60.3 million.

Following the expiry of our concession contract with the municipality of Iperó, the municipality filed a repossession lawsuit requesting the repossession of assets relating to water and sewage services. In response, we filed a lawsuit on December 30, 2009 to maintain possession or to collect indemnities. A temporary injunction was granted in our favor on January 5, 2010, but it was thereafter annulled by the court of first instance on January 6, 2010. We filed an interlocutory appeal, but it was not accepted. Currently, this lawsuit is at the appeals stage with respect to the submissions by both parties. We also filed a precautionary early evidence order in the jurisdiction of the Secretariat of Treasury, which resulted in a summary judgment requiring the early presentation of evidence to establish what assets are related to the provision of the services rendered by us in the municipality of Iperó.

The municipality of Tarumã filed a lawsuit against us in July 2010 requesting an interim injunction requiring (i) the repossession of existing assets necessary for providing water and sewage collection, distribution and treatment services, and (ii) the presentation of documentation demonstrating current income and expenses in the municipality and invoices for services and goods purchased by us to provide services, in order to calculate the indemnity due under article 35, paragraph 4, of the Federal Concessions Law 8,987/95. The lawsuit requested (i) a search warrant if we did not provide the income and expenses information and invoices, (ii) the imposition of a daily fine against us and (iii) that the interim injunction be converted into a permanent order, with the declared assets remaining under the control of the municipality until the payment of the indemnity provided for under article 36 of the Federal Concessions Law. The court denied the municipality's requested and we restarted the water distribution and sewage collection services in that area. We await a final decision from the court on the matter.

We filed an ordinary action against the municipality of President Prudente on January 12, 2001, seeking (i) a declaration in respect of its contractual right to continue to render the services under its concession agreement in the municipality until the formal legal rescission of the concession agreement and (ii) the payment of indemnities. The action also sought a declaration that the acts and threats of the municipality in connection with its planned expropriation were illegal and abusive. A judgment has been handed down confirming our right to continue to render the services. The decision was appealed, and the decision of the appeal court is still pending. Under an injunction currently in force until an indemnification is paid, we continue to render services in the municipality of Presidente Prudente.

In March 2011, we filed a repossession lawsuit against the municipality of Álvares Florence, which terminated our concession contract and took possession of our installations. We requested an interim injunction requiring (i) the repossession of existing assets necessary for providing water and sewage collection, distribution and treatment services, and (ii) the observation of our contractual right to continue to render the services under its concession agreement in the municipality until the formal legal rescission of the concession agreement. The lawsuit also requested that the interim injunction be converted into a permanent order. The first instance court has denied our injunction claim, keeping the municipality in charge of the water and sewage collection services. The court also denied our claim for a permanent order to which we filed an appeal which is currently under the review of the trial court.

In August 2011, we filed a repossession lawsuit against the municipality of Macatuba, which terminated our concession contract and took possession of our sewage collection and water installations. We requested an interim injunction requiring (i) the repossession of existing assets necessary for providing water and sewage collection, distribution and treatment services, and (ii) the observation of our contractual right to continue to render the services under its concession agreement in the municipality until the formal legal rescission of the concession agreement. The lawsuit also requested that the interim injunction be converted into a permanent order. The first instance court has denied our injunction claim, keeping the municipality in charge of the water and sewage collection services. We await the decision of the first instance court on the merits of the claim.

Tariff-Related Legal Proceedings and Consumer Claims

As of December 31, 2011, approximately 1,500 lawsuits had been brought by our commercial customers that claim that their tariff rates should be equal to those of another category of customers and, consequently, seek the reimbursement of the difference between the amounts we collected and those tariffs. We have obtained final decisions both in favor and against us in many of these lawsuits, and have provisioned R$618.5 million as of December 31, 2011 for those lawsuits for which we have determined that the risk of loss is probable.

The Association of Distinguished Bars and Restaurants (*Associação de Bares e Restaurantes Diferenciados*) has initiated several lawsuits to challenge the 10.0% penalty fee we charge on late water and sewage payments. In several of these cases, trial courts have dismissed the lawsuits based on the plaintiffs' lack of standing to initiate such a lawsuit. In other cases, the lawsuits were dismissed because a civil public action with respect to the same matter was already being heard in the civil courts of the State of São Paulo. In this civil public action, the civil courts ruled against us, and we have appealed the decision and a decision from the appellate court is still pending. Notwithstanding these legal proceedings, we have reduced to 2.0% the penalty fee we charge all of our customers on late bill payments.

Contractors' Claims

Certain contractors have filed claims against us alleging damages and underpayment of inflation indexation adjustments, monetary losses incurred in connection with introduction of the real and economic instability of the contract, among other claims. These suits are being handled by different courts, and we have established provisions for them when the expectation of loss is considered probable. As of December 31, 2011, we had recorded a provision of R$420.8 million for claims whose likelihood of loss is considered probable.

Other Legal Proceedings

We are a party to several civil lawsuits related to indemnities for property damage, pain and suffering, and loss of profits allegedly caused to third parties. In the year ended December 31, 2011, there was an increase both in the number of lawsuits with probable and possible risk of loss, arising from the increase in lawsuits and the review of the expected outcomes, comprising monetary adjustment, interest and fees. As of December 31, 2011, we had recorded a provision of R$178.4 million, for claims whose likelihood of loss is considered probable.

The São Paulo State Public Attorney's Office has filed a public civil action against us seeking (i) to ensure water supply in the municipality of Guarujá is within accepted levels of potability and in accordance with current legislation; (ii) to require us to start building a water treatment station; (iii) to require us to reimburse fees charged to consumers; and (iv) to require us to pay compensation for physical harm and pain and suffering caused by allegedly improper water consumption. A temporary injunction was granted to the São Paulo State Public Attorney's Office, and we appealed the decision. Our appeal was rejected by the appellate court. We have presented an answer to the complaint, and the lawsuit is currently in the discovery phase. We have not yet estimated our potential liability with respect to this lawsuit because we currently do not have sufficient information to accurately do so. We evaluated this proceeding as a possible loss.

On October 29, 2003, the São Paulo State Public Attorney's Office, on behalf of the people of the State of São Paulo, filed a civil public action in a trial court of the State of São Paulo alleging that a transfer to us of ownership of the Alto Tietê System reservoirs from the DAEE would be illegal. In October 2004, the court of first instance handed down its judgment on the civil public action and declared the agreement between us, DAEE and the State of São Paulo null and void. This decision was suspended and we, the State Treasury and DAEE appealed the decision. On August 23, 2010, the appeal was denied. We have petitioned for clarification of the appeal court's decision and will seek to take the case

to the Supreme Court. The effects of the appeal court's decision will be suspended until the end of the legal process. Our legal counsel has assessed the risk of loss as probable, which would prohibit the transfer of the reservoirs in payment of the accounts receivable due from the State.

We are a party to a substantial number of other legal proceedings, in addition to the lawsuits and administrative proceedings discussed above, in the ordinary course of our business. These legal proceedings include personal injury and property damage cases, environmental proceedings, challenges to our ability to cease rendering water and sewage services upon default by our customers and a range of other matters. We have not established provisions with respect to these other legal proceedings.

Dividends and Dividend Policy

Amounts Available for Distribution

At each annual shareholders' meeting, the board of directors is required to recommend the allocation of net profits for the preceding fiscal year. For purposes of Brazilian Corporate Law, net profits are defined as net income after income tax and social contribution tax for such fiscal year, net of any accumulated losses from prior fiscal years and any amounts allocated to employees' and management's participation in our profits. In accordance with Brazilian Corporate Law, the amounts available for dividend distribution are the amounts equal to our net profits less any amounts allocated from such net profits to:

§ the legal reserve; and

§ retained earnings for investment reserve.

We are required to maintain a legal reserve, to which we must allocate 5.0% of net profits for each fiscal year until the amount for such reserve equals 20.0% of our paid-in capital. However, we are not required to make any allocations to our legal reserve in respect of any fiscal year in which the aggregate amount of the legal reserve plus our other established capital reserves exceeds 30.0% of our capital. Net losses, if any, may be offset against the legal reserve. As of December 31, 2011, 2010 and 2009 the balance of our legal reserve was R$521.2 million, R$460.0 million and R$378.5 million, respectively, which was equal to 8.4%, 7.4% and 6.1%, respectively, of our capital.

Brazilian Corporate Law also provides for two discretionary allocations of net profits that are subject to approval by the shareholders at each annual shareholders' meeting. First, a percentage of net profits may be allocated to a contingency reserve for anticipated losses that are deemed probable in future years. Any amount so allocated in a prior year must be either reversed in the fiscal year in which the loss was anticipated if such loss does not in fact occur, or written off in the event that the anticipated loss occurs. Second, if the mandatory distributable amount exceeds the sum of realized net profits in any given year, such excess may be allocated to an unrealized revenue reserve. Under Brazilian Corporate Law, realized net profits is defined as the amount of net profits that exceeds the net positive result of equity adjustments and profits or revenues from operations with financial results after the end of the next succeeding fiscal year.

Under Brazilian Corporate Law, any company may authorize in its bylaws the creation of a discretionary reserve. Bylaws which authorize the allocation of a percentage of a company's net income to the discretionary reserve must also indicate the purpose, criteria for allocation and maximum amount of the reserve. We may also allocate a portion of our net profits for discretionary allocations for plan expansion and other capital investment projects, the amount of which would be based on a capital budget previously presented by management and approved by our shareholders. Under Law No. 10,313 of October 3, 2001, capital budgets for more than one year must be revised at each annual shareholders' meeting. After completion of the relevant capital projects, we may retain the allocation until the shareholders vote to transfer all or a portion of the reserve to capital or retained earnings. As of December 31, 2011, 2010 and 2009 we had an investment reserve of R$3,408.6 million, R$2,825.0 million and R$1,732.1 million, respectively.

The amounts available for distribution may be further increased by a reversion of the contingency reserve for anticipated losses constituted in prior years but not realized. The amounts available for distribution are determined on the basis of financial statements prepared in accordance with Brazilian GAAP, which does not differ from IFRS.

The legal reserve is subject to approval by the shareholder vote at our annual shareholders' meeting and may be transferred to capital but is not available for the payment of dividends in subsequent years. Our calculation of net profits and allocations to reserves for any fiscal year are determined on the basis of financial statements prepared in accordance with Brazilian GAAP.

Mandatory Distribution

Brazilian Corporate Law generally requires that the bylaws of each Brazilian corporation specify a minimum percentage of the amounts available for distribution by such corporation for each fiscal year that must be distributed to shareholders as dividends, also known as the mandatory distributable amount. Under our bylaws, the mandatory distributable amount has been fixed at an amount equal to not less than 25.0% of the amounts available for distribution, to the extent amounts are available for distribution at the end of each given fiscal year.

The mandatory distribution is based on a percentage of adjusted net income, not lower than 25.0%, rather than a fixed monetary amount per share. Brazilian Corporate Law, however, permits a publicly held company, such as us, to suspend the mandatory distribution if the board of directors and the fiscal committee report to the shareholders' meeting that the distribution would be inadvisable in view of the company's financial condition. The suspension is subject to the approval of holders of common shares. In this case, the board of directors must file a justification for such suspension with the CVM. Profits not distributed by virtue of the suspension mentioned above shall be attributed to a special reserve and, if not absorbed by subsequent losses, must be paid as dividends as soon as the financial condition of such company permits such payments.

Payment of Dividends

We are required by Brazilian Corporate Law and by our bylaws to hold an annual shareholders' meeting by the fourth month after the end of each fiscal year at which, among other things, the shareholders have to decide on the payment of an annual dividend when profits were accrued. The decision to distribute annual dividends is based on the financial statements prepared for the relevant fiscal year. Under Brazilian Corporate Law, dividends generally are required to be paid within 60 days following the date the dividend was declared, unless a shareholders' resolution sets forth another date for payment, which, in either case, must occur prior to the end of the fiscal year in which the dividend was declared. A shareholder has a three year period from the dividend payment date to claim dividends (or interest payments on shareholders' equity as described under "—Record of Dividend Payments and Interest on Shareholders' Equity") distributed on his or her shares, after which the amount of the unclaimed dividends reverts to us. The depositary will set the currency exchange date to be used for payments to ADS holders as soon as practicable upon receipt of those payments from us.

Our bylaws allow us to pay interim dividends from preexisting and accumulated profits related to the current or preceding fiscal year.

In general, shareholders who are not residents of Brazil must register with the Central Bank to have dividends, sales proceeds or other amounts with respect to their shares eligible to be remitted outside of Brazil. The common shares underlying our ADSs are held in Brazil by Banco Itaú Unibanco S.A., as the custodian and agent for the depositary, which is the registered owner of the common shares underlying the ADSs. Our current registrar is Banco Itaú Unibanco S.A. The depositary electronically registers the common shares underlying the ADSs with the Central Bank and, therefore, is able to have dividends, sales proceeds or other amounts with respect to these shares eligible to be remitted outside Brazil. See "Item 10.D. Exchange Controls."

Payments of cash dividends and distributions, if any, will be made in Brazilian reais to the custodian on behalf of the depositary, which will then convert such proceeds into U.S. dollars and will cause such U.S. dollars to be delivered to the depositary for distribution to holders of ADSs. See "Item 10.D. Additional Information—Exchange Controls." Under current Brazilian law, dividends generally paid to shareholders who are not Brazilian residents, including holders of ADSs, will not be subject to Brazilian withholding income tax, except for dividends declared based on profits generated prior to December 31, 1995. See "Item 10.E. Taxation."

Record of Dividend Payments and Interest on Shareholders' Equity

Brazilian corporations are permitted to distribute dividends in the form of a tax-deductible notional interest expense on shareholders' equity in accordance with Law No. 9,249 of December 26, 1995, as amended. The rate at which tax-deductible interest may be paid is limited to the product of the average TJLP and shareholders' equity during the relevant period and cannot exceed the greater of:

- § 50.0% of net income (before taking into account such distribution and any deductions for income taxes and after taking into account any deductions for social contributions on net profits) for the period in respect of which the payment is made; or

- § 50.0% of earnings reserves and retained earnings.

Any payment of interest on shareholders' equity to holders of ADSs or common shares, whether or not they are Brazilian residents, is subject to Brazilian withholding income tax at the rate of 15.0% or 25.0% if the beneficiary is resident in a tax haven. See "Item 10.E. Taxation." The amount paid to shareholders as interest on shareholders' equity, net of any withholding tax, may be included as part of any mandatory distributable amount.

Dividends and interest on shareholders' equity over the minimum established in a company's bylaws are recognized when approved by the shareholders in the general meeting. Consequently, the amounts recognized as of December 31, 2011, correspond to the minimum established by law of 25.0% of the net profit and the difference was recorded on April 23, 2012 totaling R$ 578.7 million.

Distributions of dividends

The following table sets forth the distributions of dividends that we made to our shareholders in respect of our 2009, 2010 and 2011 earnings. All these amounts distributed or to be distributed were or will be in the form of interest on shareholders' equity.

Year ended December 31,	**Aggregate amount distributed** (in millions of *reais*)	**Payment Dates**	**Payment per share**	**Payment per ADS** (in *reais*)
2009	394.2	June 28, 2010	1.73	3.46
2010	456.0(*)	June 28, 2011	2.00	4.00
2011	578.7(**)	(**)	2.54	5.08

(*) We recorded dividends in the amount of R$387.2 million, which pursuant to our bylaws is our minimum dividend amount.

(**) We recorded dividends in the amount of R$290.6 million, which pursuant to our bylaws is our minimum dividend amount. The dividends will be paid until 60 days after the Ordinary General Meeting, which occurred on April 23, 2012.

Dividend Policy

We intend to declare and pay dividends and/or interest on shareholders' equity, as required by Brazilian Corporate Law and our bylaws. Our board of directors may approve the distribution of interest on shareholders' equity, calculated based on our semiannual or quarterly financial statements. The declaration of dividends is annual, including dividends in excess of the mandatory distribution, and requires approval by the vote of the majority of the holders of our common shares. The amount of any distributions will depend on many factors, such as our results of operations, financial condition, cash requirements, prospects and other factors deemed relevant by our board of directors and shareholders. Within the context of our tax planning, we may in the future continue to determine that it is in our best interest to distribute interest on shareholders' equity.

B. Significant Changes

We are not aware of any significant changes bearing upon our financial condition since the date of the consolidated financial statements included in this annual report.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

Market Price of Common Shares

Our common shares have been listed on the BM&FBOVESPA under the symbol "SBSP3" since June 4, 1997 and, starting on April 24, 2002, have been included in the *Novo Mercado* segment of that exchange. As of December 31, 2011, we had 2,767 registered holders of common shares.

On April 30, 2007, our shareholders approved a reverse stock split of 125 common shares into one common share. IFRS requires the retroactive restatement of earnings-per-share computations for stock dividends, stock splits, and reverse splits.

The table below sets forth, for the periods indicated, the reported high and low closing sale prices in reais for common shares on the BM&FBOVESPA. The table also sets forth prices per ADS assuming that ADSs had been outstanding on all such dates and translated into U.S. dollars at the commercial market rate for the sale of U.S. dollars for each of the respective dates of such quotations. In addition, the table sets forth the average daily trading volume for our common shares.

	Reais per common share		U.S. dollar equivalent per ADS (1)		Average daily
	Low	High	Low	High	trading volume
2008	18.11	46.50	16.08	56.02	384,463
2009	21.87	37.19	18.39	43.66	351,874
First quarter	21.87	28.86	18.39	24.77	360,725
Second quarter	25.10	32.25	22.56	32.02	334,721
Third quarter	27.50	35.38	29.07	39.18	397,366
Fourth quarter	31.15	37.19	35.79	43.66	306,677
2010	30.27	44.47	32.70	52.56	311,996
First quarter	30.27	34.26	32.70	39.55	323,739
Second quarter	32.36	37.50	35.28	41.63	416,256
Third quarter	33.41	37.90	38.05	44.74	265,725
Fourth quarter	37.59	44.47	44.53	52.56	242,943
2011	39.00	52.78	48.75	56.80	258,827
First quarter	40.10	47.00	47.91	57.71	282,548
Second quarter	45.00	49.50	56.39	60.75	267,042
Third quarter	39.00	48.03	48.75	61.43	245,275
Fourth quarter	43.03	52.78	45.75	56.80	241,197
2012					
January	50.42	58.34	53.97	67.09	349,214
February	58.00	64.85	66.95	75.88	495,100
March	65.00	69.66	75.79	76.46	288,000
April (through April 23, 2012)	65.50	73.65	74.85	80.43	332,131

(1) Each ADS is equal 2 common shares

Market Price of ADSs

Our ADSs, each of which represent two of our common shares, as of the date of this annual report, are listed on the NYSE under the symbol “SBS.” Prior to June 8, 2007, each ADS represented 250 of our common shares. Our ADSs began trading on the NYSE on May 10, 2002 in connection with the initial offering of our equity securities in the United States.

The table below sets forth, for the periods indicated, the reported high and low closing prices for our ADSs on the NYSE.

	Price in U.S. dollars per ADS		
	Low	High	Average daily trading volume
2006	17.21	35.35	321,105
2007	29.15	53.57	323,404
2008	16.76	56.35	414,961
2009	18.03	43.40	331,673
First quarter	18.03	25.12	382,314
Second quarter	22.74	32.27	358,534
Third quarter	27.74	39.51	296,588

Fourth quarter	36.58	43.40	292,049
2010	33.09	53.18	275,432
First quarter	33.09	40.16	262,525
Second quarter	35.33	41.54	337,808
Third quarter	37.97	45.51	266,393
Fourth quarter	45.15	53.18	234,667
2011	46.35	63.63	263,370
First quarter	48.60	58.74	297,927
Second quarter	56.91	62.63	284,122
Third quarter	46.35	62.07	263,200
Fourth quarter	46.74	56.66	215,152
2012			
January	56.62	66.91	279,963
February	67.43	75.12	443,328
March	73.23	76.86	278,767
April (through April 23, 2012)	74.11	80.18	276,903

B. Plan of Distribution

Not applicable.

C. Markets

Trading on the Brazilian Stock Exchanges

The BM&FBOVESPA stock and futures exchange is a corporation where all stock and futures trades in Brazil are carried out, with the exception of public-debt bonds, which are traded electronically, and the privatization auctions, which are run by the Rio de Janeiro Stock Exchange.

Trading on the BM&FBOVESPA is limited to brokerage firms and is conducted between 10:00 a.m. and 5:00 p.m., or between 11:00 a.m. and 6:00 p.m. during daylight savings time in Brazil. The BM&FBOVESPA also permits trading from 5:45 p.m. to 7:00 p.m., or between 6:45 p.m. to 7:30 p.m. during daylight savings time in Brazil, during a different trading period of time, called the "after market." Trading on the after market is subject to regulatory limits on price volatility and on the volume of shares transacted through Internet brokers.

In order to maintain better quality control over the fluctuation of its index, BM&FBOVESPA has adopted a "circuit breaker" system pursuant to which trading sessions are suspended for a period of 30 minutes or an hour whenever the BM&FBOVESPA index falls below the limits of 10.0% or 15.0%, respectively, in relation to the index at the closing of the previous trading session.

BM&FBOVESPA settles the sale of shares three business days after they have taken place, without monetary adjustment of the purchase price. The shares are paid for and delivered through a settlement agent affiliated with the BM&FBOVESPA. The BM&FBOVESPA performs multilateral compensation for both the financial obligations and the delivery of shares. According to the BM&FBOVESPA's regulations, financial settlement is carried out by the Central Bank's reserve transfer system. The securities are transferred by the BM&FBOVESPA's custody system. Both delivery and payment are final and irrevocable.

Trading on the BM&FBOVESPA is significantly less liquid than trading on the NYSE or other major exchanges in the world. Although any of the outstanding shares of a listed company may trade on the BM&FBOVESPA, in most cases fewer than half of the listed shares are actually available for trading by the public, the remainder being held by a controlling group or by government entities. As of the end of 2011, the BM&FBOVESPA had a total market capitalization of approximately US$1.2 billion (R$2.3 billion) and an average daily trading volume of US$3.9 billion (R$6.2 billion). The top ten stocks in terms of 2011 trading volume accounted for approximately 47.2% of all shares traded on the BM&FBOVESPA as of December 31, 2011. As of December 31, 2011, we accounted for approximately 0.5% of the market capitalization of all listed companies on BM&FBOVESPA.

Trading on the BM&FBOVESPA by a holder not deemed to be domiciled in Brazil for Brazilian tax and regulatory purposes, or a "non-Brazilian holder," is subject to certain limitations under Brazilian foreign investment regulations. With limited exceptions, non-Brazilian holders may trade on Brazilian stock exchanges in accordance with the requirements of CMN Resolution No. 2,689, which requires that securities held by non-Brazilian holders be maintained in the custody of financial institutions authorized by the Central Bank and by the CVM or in deposit accounts with financial institutions. In addition, Resolution No. 2,689 requires non-Brazilian holders to restrict their securities trading to transactions on the BM&FBOVESPA or qualified over-the-counter markets. With limited exceptions, non-Brazilian holders may not transfer the ownership of investments made under Resolution No. 2,689 to other non Brazilian holders through a private transaction. See "Item 10.E. Taxation—Brazilian Tax

Considerations—Taxation of Gains" for a description of certain tax benefits extended to non Brazilian holders who qualify under Resolution No. 2,689.

The* Novo Mercado *Segment

Since April 24, 2002, our common shares have been listed on the *Novo Mercado* segment of the BM&FBOVESPA. The *Novo Mercado* is a listing segment designed for the trading of shares issued by companies that voluntarily undertake to abide by some additional corporate governance practices and disclosure requirements in addition to those already required under Brazilian law. A company in the *Novo Mercado* must follow good practices of corporate governance. These rules generally increase shareholders' rights and enhance the quality of information provided to shareholders. On April 18, 2002 and on June 19, 2006, our shareholders approved changes to our bylaws to comply with the *Novo Mercado* requirements. In addition, the *Novo Mercado* provides for the creation of a Market Arbitration Chamber for conflict resolution between investors and companies listed in the *Novo Mercado*.

In addition to the obligations imposed by current Brazilian law, a company listed on the *Novo Mercado* is obligated to:

- § maintain only voting shares;
- § hold public offerings of shares in a manner favoring diversification of the company's shareholder base and broader access to retail investors;
- § maintain a minimum free float of at least 25.0% of the outstanding capital stock of the company;
- § grant tag along rights for all shareholders in connection with a transfer of control of the company;
- § limit the term of all members of the board of directors to two years;
- § ensure that at least 20.0% of the members of the board of directors are independent, as defined under the Novo Mercado regulation;
- § prepare annual, including cash flow statements, in compliance with U.S. GAAP or IFRS or reconciled from Brazilian GAAP to U.S. GAAP or IFRS;
- § disclose information on a quarterly basis, including share ownership of certain of our employees and directors and amount of free float of shares;
- § hold a tender offer by the company's controlling shareholder (the minimum price of the shares to be offered will be determined by an appraisal process) if it elects to delist from the Novo Mercado; and
- § make greater disclosure of related party transactions.

On May 10, 2011, the *Novo Mercado* rules were revised and currently establish the following additional obligations:

- § the chairman of the board of directors is prohibited from simultaneously holding the position of chief executive officer;
- § the board of directors must disclose its opinion on take over proposals within 15 days from the presentation of the proposal; and
- § the company must have a securities purchase policy and a code of ethics.

Regulation of Brazilian Securities Markets

The Brazilian securities markets are principally governed by Law No. 6,385 of December 7, 1976, and Brazilian Corporate Law, each as amended and supplemented, and by regulations issued by the CVM, which has regulatory authority over the stock exchanges and securities markets generally, by the CMN, and by the Central Bank, which has licensing authority over brokerage firms and regulates foreign investment and foreign exchange transactions. These laws and regulations, among others, provide for disclosure requirements applicable to issuers of traded securities, protection of minority shareholders and criminal penalties for insider trading and price manipulation. They also provide for licensing and oversight of brokerage firms and governance of the Brazilian stock exchanges. Nevertheless, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets.

Under Brazilian Corporate Law, a company is either public (*companhia aberta*), such as we are, or closely held (*companhia fechada*). All public companies, including us, are registered with the CVM and are subject to reporting requirements. A company registered with the CVM may have its securities traded on the Brazilian stock exchanges or in the Brazilian over the counter market. Our common shares are listed and traded on the BM&FBOVESPA and may be traded privately subject to some limitations.

To be listed on a Brazilian stock exchange a company must apply for registration with the CVM and the stock exchange where the head office of the company is located.

We have the option to ask that trading in our securities on the BM&FBOVESPA be suspended in anticipation of a material announcement. Trading may also be suspended on the initiative of the BM&FBOVESPA or the CVM, among other reasons, based on or due to a belief that a company has provided inadequate information regarding a material event or has provided inadequate responses to the inquiries by the CVM or the São Paulo Stock Exchange.

The Brazilian over-the-counter market consists of direct trades between individuals in which a financial institution registered with the CVM serves as intermediary. No special application, other than registration with the CVM, is necessary for securities of a public company to be traded in this market. The CVM requires that it be given notice of all trades carried out in the Brazilian over-the-counter market by the respective intermediaries.

Trading on the BM&FBOVESPA by non-residents of Brazil is subject to limitations under Brazilian foreign investment and tax legislation. The Brazilian custodian for our common shares underlying the ADSs must, on behalf of the depositary for our ADSs, obtain registration from the Central Bank to remit U.S. dollars abroad for payments of dividends, any other cash distributions, or upon the disposition of the shares and sales proceeds thereto. In the event that a holder of ADSs exchanges ADSs for common shares, the holder will be entitled to continue to rely on the custodian's registration for five business days after the exchange. Thereafter, 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 the holder obtains a new registration. See "Item 10.D. Exchange Controls."

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

The following is a summary of the material terms of our common shares, including related provisions of our bylaws and Brazilian Corporate Law. This description is qualified by reference to our bylaws and to Brazilian law.

Corporate Purposes

We are a mixed capital company (*sociedade de economia mista*) of unlimited duration, incorporated on September 6, 1973, with limited liability, duly organized and operating under Brazilian Corporate Law. As set forth in Article 2 of our bylaws, our corporate purpose is to render basic sanitation services, aimed at the universalization of basic sanitation in the State of São Paulo without harming our long-term financial sustainability. Our activities comprise water supply, sanitary sewage services, urban rainwater management and drainage services, urban cleaning services solid waste management services and related activities, including the planning, operation, maintenance and commercialization of energy, and the commercialization of services, products, benefits and rights that directly or indirectly arise from its assets, operations and activities. We are allowed to act, in a subsidiary form, in other Brazilian locations and abroad.

Directors' Powers

Although our bylaws contain no specific provisions regarding a director or executive officer's power to vote on a proposal, arrangement or contract in which that director has a material interest, under Brazilian Corporate Law, a director or an executive officer is prohibited from voting in any meeting or with respect to any transaction in which that director or executive officer has a conflict of interest with the company and must disclose the nature and extent of the conflicting interest to be recorded in the minutes of the meeting. In any case, a director or an executive officer may not transact any business with the company, including any borrowing, except on reasonable or fair terms and conditions that are identical to the terms and conditions prevailing in the market or offered by third parties.

Under our bylaws, our shareholders are responsible for establishing the compensation we pay to the members of our board of directors, members of the fiscal committee and the executive officers.

Pursuant to Brazilian Corporate Law, each member of our board of directors must be a resident of Brazil. Our bylaws do not establish any mandatory retirement age limit.

See also "Item 6.A. Directors and Senior Management."

Description of Common Shares

General

Each common share entitles the holder thereof to one vote at our annual or special shareholders' meetings. Brazilian Corporate Law requires that all our shareholders' meetings be called by publication of a notice in the *Diário Oficial do Estado de São Paulo*, the official government publication of the State of São Paulo, and in a newspaper of general circulation in our principal place of business, currently the city of São Paulo, at least fifteen days prior to the meeting. In addition, the CVM may also require the first call for a shareholders' meeting to be up to 30 days before such shareholders' meeting. The quorum to hold shareholders' meetings on first call requires the attendance of shareholders, either in person or by proxy, representing at least 25.0% of the shares entitled to vote and, on second call, the meetings can be held with the attendance of shareholders, also either in person or by proxy, representing any number of shares entitled to vote.

Under Brazilian Corporate Law, our common shares are entitled to dividends or other distributions made in respect of our common shares in proportion to their share of the amount available for the dividend or distribution. See "Item 8.A. Consolidated Statements and Other Financial Information—Dividends and Dividend Policy" for a more complete description of payment of dividends and other distributions on our common shares. In addition, upon any liquidation of our Company, our common shares are entitled to our remaining capital after paying our creditors in proportion to their ownership interest in us.

In principle, a change in shareholder rights, such as the reduction of the compulsory minimum dividend, is subject to a favorable vote of the shareholders representing at least one half of our voting shares. Under some circumstances that may result in a change in the shareholder rights, such as the creation of preferred shares, Brazilian Corporate Law requires the approval of a majority of the shareholders who would be adversely affected by the change attending a special meeting called for such reason. It should be emphasized, however, that our by-laws expressly prevents us from issuing preferred shares. Brazilian Corporate Law specifies other circumstances where a dissenting shareholder may also have appraisal rights.

According to Brazilian Corporate Law, neither a company's bylaws nor actions taken at a general meeting of shareholders may deprive a shareholder of certain rights, such as:

- the right to participate in the distribution of profits;
- the right to participate equally and ratably in any remaining residual assets in the event of liquidation of the company;
- the right to supervise the management of the corporate business as specified in Brazilian Corporate Law;

- the right to preemptive rights in the event of a subscription of shares, debentures convertible into shares or subscription bonuses (except in some specific circumstances under Brazilian law); and

- the right to withdraw from the company in the cases specified in Brazilian Corporate Law.

Pursuant to Brazilian Corporate Law and our bylaws, each of our common shares carries the right to one vote at our shareholders' meetings. We may not restrain or deny that right without the consent of the holders of a majority of the shares affected.

Neither Brazilian Corporate Law nor our bylaws expressly addresses:

- staggered terms for directors;
- cumulative voting, except as described below; or
- measures that could prevent a takeover attempt.

However, under the laws of the State of São Paulo, the State is required to own at least a majority of our outstanding common shares.

According to Brazilian Corporate Law and its regulations, shareholders representing at least five per cent of our capital, may request that a multiple voting procedure be adopted to entitle each share to as many votes as there are board members and to give each shareholder the right to vote cumulatively for only one candidate or to distribute their votes among several candidates. Pursuant to Brazilian Corporate Law, shareholder action must be taken at a shareholders meeting, duly called for and not by written consent.

In addition, shareholders owning at least 15.0% of the capital may request the right to elect, separately a member of the Board of Directors.

Preemptive Rights

Each of our shareholders has a general preemptive right to subscribe for shares or securities convertible into shares in any capital increase, in proportion to his or her ownership interest in us, except in the event of the grant and exercise of any option to acquire shares of our capital stock. The preemptive rights are valid for a 30 day period from the publication of the announcement of the capital increase. Shareholders are also entitled to sell this preemptive right to third parties. Under Brazilian Corporate Law, we may amend our bylaws to eliminate preemptive rights or to reduce the exercise period in connection with a public offering of shares or an exchange offer made to acquire another company. Currently, our bylaws provide our shareholders with preemptive rights with respect to any offering.

In the event of a capital increase by means of the issuance of new shares, holders of ADSs, or of common shares, would, except under circumstances described above, have preemptive rights to subscribe for any class of our newly issued shares. However, an ADS 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 Securities Act is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. See “Item 3.D. Risk Factors - Risks Relating to Our Common Shares and ADSs - 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.”

Redemption and Rights of Withdrawal

Brazilian Corporate Law provides that, under limited circumstances, a shareholder has the right to withdraw his or her equity interest from the company and to receive payment for the portion of shareholder’s equity attributable to his or her equity interest. This right of withdrawal may be exercised by dissenting our shareholders in the event that at least half of all voting shares outstanding authorize us:

- to reduce the mandatory distribution of dividends;
- to merge into another company or to consolidate with another company, subject to the conditions set forth in Brazilian Corporate Law;
- to participate in a centralized group of companies, as defined under Brazilian Corporate Law and subject to the conditions set forth therein;
- to change our corporate purpose;
- to split up, subject to the conditions set forth in Brazilian Corporate Law;
- to transform into another type of company;
- to transfer all of our shares to another company or to receive shares of another company in order to make the company whose shares are transferred a wholly owned subsidiary of such company, known as *incorporação de ações*; or

§ to acquire control of another company at a price which exceeds the limits set forth in Brazilian Corporate Law.

The right of withdrawal lapses 30 days after publication of the minutes of the shareholders' meeting that approved a corporate action described above. We would be entitled to reconsider any action giving rise to withdrawal rights within 10 days following the expiration of such rights if the withdrawal of shares of dissenting shareholders would jeopardize our financial condition. Brazilian Corporate Law allows companies to redeem their shares at their economic value, subject to the provisions of their bylaws and certain other requirements. Our bylaws currently do not provide that our capital stock will be redeemable at its economic value and, consequently, any redemption pursuant to Brazilian Corporate Law would be made based on the book value per share, determined on the basis of the last balance sheet approved by the shareholders. However, if a shareholders' meeting giving rise to redemption rights occurred more than 60 days after the date of the last approved balance sheet, a shareholder would be entitled to demand that his or her shares be valued on the basis of a new balance sheet dated within 60 days of such shareholders' meeting.

In addition, the rights of withdrawal in the third, fourth and eighth bullet points above may not be exercised by holders of shares if such shares (i) are liquid, defined as being part of the BM&FBOVESPA index or other stock exchange index (as defined by the CVM), and (ii) are widely held, such that the controlling shareholder or companies it controls have less than 50.0% of our shares. Our common shares are included on the BM&FBOVESPA index.

This right of withdrawal may also be exercised in the event that the entity resulting from a merger, incorporação de ações, as described above, consolidation or spin off of a listed company fails to become a listed company within 120 days of the shareholders' meeting at which such transaction was approved.

We may cancel the right of withdrawal if the payment amount has a material adverse effect on our finances.

Conversion Right

Not applicable because our capital stock is only comprised of common shares.

Especial and General Meetings

Unlike the laws governing corporations incorporated under the laws of the State of Delaware, the Brazilian corporation law does not allow shareholders to approve matters by written consent obtained as a response to a consent solicitation procedure. All matters subject to approval by the shareholders must be approved in a general meeting, duly convened pursuant to the provisions of Brazilian corporation law. Shareholders may be represented at a shareholders' meeting by attorneys-in-fact who are (i) shareholders of the corporation, (ii) a Brazilian attorney, (iii) a member of management or (iv) a financial institution.

General shareholders' meetings may be called by publication of a notice in the *Diário Oficial do Estado de São Paulo* and in a newspaper of general circulation in our principal place of business at least 15 days prior to the meeting. Special meetings are convened in the same manner as general shareholders' meetings and may occur immediately before or after a general meeting.

At duly called and convened meetings, our shareholders are empowered to take any action regarding our business. Shareholders have the exclusive right, during our annual shareholders' meetings required to be hold within 120 days of the end of our fiscal year, to approve our financial statements and to determine the allocation of our net income and the distribution of dividends related to the fiscal year immediately preceding the meeting. The members of our board of directors are generally elected at annual shareholders' meetings. However, according to Brazilian corporation law,

they can also be elected at extraordinary shareholders' meetings. At the request of shareholders holding a sufficient number of shares, a fiscal committee can be established and its members elected at any shareholders' meeting.

A special shareholders' meeting may be held concurrently with the annual shareholders' meeting and at other times during the year. Our shareholders may take the following actions, among others, exclusively at shareholders' meetings:

§ election and dismissal of the members of our board of directors and our fiscal committee, if the shareholders have requested the set up of the latter;

- § approval of the aggregate compensation of the members of our board of directors and board of executive officers, as well as the compensation of the members of the fiscal committee, if one has been established;
- § amendment of our bylaws;
- § approval of our merger, consolidation or spin-off;
- § approval of our dissolution or liquidation, as well as the election and dismissal of liquidators and the approval of their accounts;
- § granting stock awards and approval of stock splits or reverse stock splits;
- § approval of stock option plans for our management and employees, as well as for the management and employees of other companies directly or indirectly controlled by us;
- § approval, in accordance with the proposal submitted by our board of directors, of the distribution of our net income and payment of dividends;
- § authorization to delist from the Level 2 of Differentiated Corporate Governance Practices and to become a private company, except if the cancellation is due to a breach of the Level 2 regulations by management, and to retain a specialized firm to prepare a valuation report with respect to the value of our shares, in any such events;
- § approval of our management accounts and our financial statements;
- § approval of any primary public offering of our shares or securities convertible into our shares; and
- § deliberate upon any matter submitted by the board of directors.

Limitations on Rights to Own Securities

There are no limitations under Brazilian law and our bylaws on the rights of non-residents or foreign shareholders to own securities, including the rights of such non-resident or foreign shareholders to hold or exercise voting rights.

Anti-Takeover Provisions

Pursuant to article 40 of our bylaws and the *Novo Mercado* regulations, any party that acquires our control must extend a tender offer for the shares held by non-controlling shareholders at the same conditions and purchase price paid to the controlling shareholder. In addition, State Law No. 119/73, which created our Company, requires the State to hold the majority of our shares at all times.

Reserves

General

The Brazilian Corporate Law provides that all discretionary allocations of "adjusted income" are subject to shareholder approval and may be added to capital or distributed as dividends in subsequent years. In the case of our capital reserve and the legal reserve, they are also subject to shareholder approval; however, the use of their respective balances is restricted to being added to capital or absorbed by losses. They cannot be used as a source for income distribution to shareholders.

Capital Reserve

Our capital reserve is comprised of tax incentives and donations from government agencies and private entities received through December 31, 2007. As of December 31, 2011, we had a capital reserve of R$124.3 million.

Investment Reserve

Our investment reserve is comprised specifically of internal funds for expansion of water and sewage service systems. As of December 31, 2011, we had an investment reserve of R$3,408.6 million.

Legal Reserve

Under Brazilian Corporate Law, we are required to record a legal reserve to which we must allocate 5% of the adjusted net income each year until the amount of the reserve equals 20.0% of paid-in capital. Any accumulated deficit may be charged against the legal reserve. As of December 31, 2011, the balance of our legal reserve was R$521.2 million.

Arbitration

In connection with our listing with the *Novo Mercado* segment of the BM&FBOVESPA, we, our shareholders, directors and officers have undertaken to refer to arbitration any and all disputes or controversies arising out of the *Novo Mercado* rules or any other corporate matters. See "Item 9.C. Markets." Under our bylaws, any dispute among us, our shareholders and our management with respect to the application of *Novo Mercado* rules, Brazilian Corporate Law, the application of the rules and regulations regarding Brazilian capital markets, will be resolved by arbitration conducted pursuant to the BM&FBOVESPA Arbitration Rules in the Market Arbitration Chamber. Any dispute among shareholders, including holders of ADSs, and any dispute between us and shareholders, including holders of ADSs, will also be submitted to arbitration.

Options

There are currently no outstanding options to purchase any of our common shares.

C. Material Contracts

For a description of the material contracts entered into by the State and us, see "Item 7.B. Related Party Transactions—Transactions with the State of São Paulo—Agreements with the State."

D. Exchange Controls

The right to convert dividend or interest payments and proceeds from the sale of shares into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally requires, among other things, that the relevant investments have been registered with the Central Bank and the CVM. Such restrictions on the remittance of foreign capital abroad may hinder or prevent the custodian for our common shares represented by our ADSs or the holders of our common shares from converting dividends, distributions or the proceeds from any sale of these shares into U.S. dollars and remitting the U.S. dollars abroad. Holders of our ADSs could be adversely affected by delays in, or refusal to grant any, required government approval to convert Brazilian currency payments on the common shares underlying our ADS and to remit the proceeds abroad.

Resolution No. 1,927 of the CMN provides for the issuance of depositary receipts in foreign markets in respect of shares of Brazilian issuers. The ADS program was approved under the Annex V Regulations by the Central Bank and the CVM prior to the issuance of the ADSs. Accordingly, the proceeds from the sale of ADSs by ADR holders outside Brazil are not subject to Brazilian foreign investment controls, and holders of the ADSs are entitled to favorable tax treatment under certain circumstances. See "Item 3.D. Risk Factors—Risks Relating to Our Common Shares and ADSs—Investors who exchange ADSs for common shares may lose their ability to remit foreign currency abroad and to obtain Brazilian tax advantages" and "Item 10.E. Taxation—Brazilian Tax Considerations."

E. Taxation

This summary contains a description of certain Brazilian and U.S. federal income tax consequences of the purchase, ownership and disposition of common shares or ADSs by a holder.

The summary is based upon the tax laws of Brazil and the federal income tax laws of the United States as in effect on the date of this annual report, which laws are subject to change, possibly with retroactive effect, regarding the U.S. federal income tax, and to differing interpretations. Holders of common shares or ADSs should consult their own tax advisors as to the Brazilian, U.S. or other tax consequences of the purchase, ownership and disposition of common shares or ADSs, including, in particular, the effect of any non-Brazilian, non-U.S., state or local tax laws.

Although there presently is no income tax treaty between Brazil and the United States, the tax authorities of the two countries have had discussions in the past regarding such a treaty. No assurance can be given, however, as to if or when a treaty will enter into force or how it will affect the U.S. holders of common shares or ADSs.

Brazilian Tax Considerations

The following discussion summarizes the principal Brazilian tax consequences of the acquisition, ownership and disposition of common shares or ADSs by a holder that is not domiciled in Brazil for purposes of Brazilian taxation (a "non Brazilian holder"). It is based on Brazilian laws and regulations as currently in effect, and, therefore, any change in such law may change the consequences described below. Each non Brazilian holder should consult his or her own tax adviser concerning the Brazilian tax consequences of an investment in common shares or ADSs.

A non Brazilian holder of ADSs may withdraw them in exchange for common shares in Brazil. Pursuant to Brazilian law, the non Brazilian holder may invest in the common shares under Resolution 2,689, of January 26, 2000, of the CMN ("2,689 holder").

Taxation of Dividends

As a result of the tax legislation adopted on December 26, 1995, dividends based on profits generated after January 1, 1996, including dividends paid in kind, payable by us in respect of common shares or ADSs, are exempt from withholding income tax. Dividends relating to profits generated prior to January 1, 1996 may be subject to Brazilian withholding income tax at varying rates, depending on the year the profits were generated.

Taxation of Gains

Gains realized outside Brazil by a non Brazilian holder on the disposition of ADSs to another non Brazilian holder are not currently subject to Brazilian tax. However, according to certain interpretations of Law no. 10,833 of December 2003, or Law No. 10,833, the disposition of assets located in Brazil by a non-Brazilian holder, whether to other non-Brazilian holder or Brazilian holders, may become subject to taxation in Brazil. Although we believe that the ADSs do not fall within the definition of assets located in Brazil for the purposes of Law no. 10,833, considering the general and unclear scope of it and the lack of definitive judicial court ruling to act as the leading case in respect thereto, we are unable to predict whether such understanding will ultimately prevail in the courts of Brazil.

Thus, the gain on disposition of ADSs by a non Brazilian holder to a resident in Brazil (or even to a non Brazilian resident in case the argument above does not prevail) may be subject to income tax in Brazil according to the rules described below for ADSs or the tax rules applicable to common shares, as applicable.

The withdrawal of ADSs in exchange for common shares is not subject to Brazilian income tax provided that the regulatory rules are appropriately observed in respect to the registration of the investment before the Central Bank of Brazil. The deposit of common shares in exchange for ADSs may be subject to Brazilian capital income tax at the rate of 15% or 25%, in case the non Brazilian holder is located in a tax haven, if the acquisition cost of the common shares is lower than (1) the average price per common share on a Brazilian stock exchange on which the greatest number of such shares were sold on the day of deposit, or (2) if no common shares were sold on that day, the average price on the Brazilian stock exchange on which the greatest number of common shares were sold in the fifteen trading sessions immediately preceding such deposit. In this case, the difference between the acquisition cost and the average price of the common shares, calculated as above, shall be considered a capital gain.

For Brazilian purposes, as of January 2009, a tax haven is considered a regime: (i) which does not impose income tax or does so at a rate of 20% or lower, or (ii) where applicable local legislation imposes restrictions on the disclosure of the shareholding composition or the ownership of investments, or on the ultimate beneficiary of the income derived

from transactions carried out and attributable to a non-Brazilian holder.

On June 24, 2008, Law No. 11,727 was enacted defining the concept of a "privileged tax regime" in connection with transactions subject to transfer pricing and thin capitalization rules. In this conception, privileged tax regimes are more comprehensive than tax havens. A "privileged tax regime" is considered to be a jurisdiction that meets any of the following requirements: (i) which does not tax income or taxes income at a maximum rate lower than 20.0%; (ii) grants tax advantages to a non-resident entity or individual (a) without requiring substantial economic activity in the jurisdiction of such non-resident entity or individual or (b) to the extent such non-resident entity or individual does not conduct substantial economic activity in the jurisdiction of such non-resident entity or individual; (iii) does not tax income generated abroad, or imposes tax on income generated abroad at a maximum rate lower than 20.0%, or (iv) restricts the ownership disclosure of assets and ownership rights or restricts disclosure about economic transactions.

Notwithstanding the fact that the "privileged tax regime" concept was enacted in connection with Brazilian transfer pricing and thin capitalization rules, there is no assurance that Brazilian tax authorities will not attempt to apply the concept of privileged tax regimes to other types of transactions, such as investments in the Brazilian financial and capital markets. We recommend that prospective investors consult their own tax advisors from time to time to verify any possible tax consequences of Law No. 11,727.

Gains realized on disposition of common shares, are subject to income tax in Brazil, regardless of whether the sale or the disposition is made by the non Brazilian holder to a resident or person domiciled in Brazil or not, based on the fact that the common shares could be considered as assets located in Brazil for purposes of Law No. 10,833.

Thus, for purposes of taxation of gains earned in a sale or disposition of common shares carried out on the Brazilian stock exchange (which includes the transactions carried out on the organized over the counter market):

- § are exempt from income tax when assessed by a 2,689 holder and is not a tax haven based holder; and
- § are subject to income tax at a rate of 15% in any other case, including gains assessed by a non-Brazilian holder that (1) is not a 2,689 holder, or (2) is a 2,689 holder but is a tax haven based holder. In these cases, a withholding income tax of 0.005% shall be applicable and can be offset with the eventual income tax due on the capital gain.

Any other gains assessed on the disposition of the common shares that are not carried out on the Brazilian stock exchange are subject to income tax a rate of 15%, except for tax haven holder which, in this case, is subject to income tax at a rate of 25%. In case these gains are related to transactions conducted on the Brazilian non organized over the counter market with intermediation, the withholding income tax of 0.005% shall also be applicable and can be offset with the eventual income tax due on the capital gain.

In the case of redemption of securities or capital reduction by a Brazilian corporation, such as ourselves, the positive difference between the amount effectively received by the non Brazilian holder and the corresponding acquisition cost is treated, for tax purposes, as capital gain derived from disposition of common shares not carried out on a Brazilian stock exchange market, and is therefore subject to income tax at the rate of 15% or 25%, as the case may be.

Any exercise of preemptive rights relating to the common shares will not be subject to Brazilian income tax. Any gain on the sale or assignment of preemptive rights relating to the common shares by a non Brazilian holder of common shares or ADSs will be subject to Brazilian taxation at the same rate applicable to the sale or disposition of common shares.

There is no assurance that the current preferential treatment for holders of ADSs and non Brazilian holders of common shares under Resolution 2,689 will continue in the future or that it will not be changed in the future. Reductions in the rate of tax provided for by Brazil's tax treaties do not apply to the tax on gains realized on sales or exchange of common shares.

Interest Attributed to Shareholders' Equity

According to Brazilian laws and our bylaws, we may opt to distribute income as interest attributed to shareholders' equity as an alternative to the payment of dividends.

Distribution of an interest on equity charge attributed to shareholders' equity in respect of the common shares or ADSs as an alternative form of payment to shareholders, including non Brazilian holders of common shares or ADSs, is

subject to Brazilian withholding income tax at the rate of 15% or 25%, in case of a tax haven based holder. Such payments, subject to certain limitations and requirements, are deductible for Brazilian income tax purposes.

Other Brazilian Taxes

There are no Brazilian inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of common shares or ADSs by a non Brazilian holder, except for gift and inheritance taxes, which are levied by some states of Brazil on gifts made or inheritances bestowed by a non Brazilian holder to individuals or entities resident or domiciled within such states in Brazil. There is no Brazilian stamp, issue, registration, or similar taxes or duties payable by a non Brazilian holder of common shares or ADSs.

Tax on Financial Transactions (Imposto sobre Operações Financeiras, or IOF)

The IOF is a tax on foreign exchange, securities, credit and insurance transactions. The IOF rate may be changed by an Presidential Decree (rather than a law). In addition, the IOF rate is not subject to the ex post facto principle, which provides that laws increasing the rate of or creating new taxes will only come into effect as of the latter of (i) the first day of the year following their publication, or (ii) ninety days after their publication, and therefore, any increase in the IOF rate has an immediate effect. A statute increasing the IOF rate will as a result only take effect from its publication date.

Although the maximum rate of IOF is 25% for foreign exchange transactions, the inflow and outflow of funds are generally subject to IOF at a rate of 0.38%; however, effective as of December 1, 2011, exchange transactions for the inflow of funds in Brazil for investments made by foreign investors are subject to IOF at a rate of 0% for variable income transactions carried out on the Brazilian stock, futures and commodities exchanges, as well as for acquisitions of common shares of Brazilian publicly-held companies in public offerings or subscription of common shares related to capital contributions, provided that the company has registered its common shares for trading on the stock exchange. The IOF rate will also be 0% for the outflow of funds from Brazil related to these type of investments, including payments of dividends and interest on shareholders' equity. Lastly, the 0% rate also applies to settlements of simultaneous foreign exchange transactions for the cancellation of depositary receipts transferred into shares traded on the stock exchange.

The IOF may also be imposed on any transactions involving bonds and securities, including those carried out on Brazilian futures and commodities stock exchanges. As a general rule, the rate of this tax for transactions involving common shares or ADSs is currently zero, although the assignment of shares traded on Brazilian stock exchanges to issue depositary receipts traded abroad is subject to IOF at the rate of 1.5%. The executive branch, also by a Presidential Decree, may increase the IOF rate by up to 1.5% per day, but only with respect to future transactions.

United States Federal Income Tax Considerations

The following discussion is a summary of certain U.S. federal income tax consequences of the acquisition, ownership and disposition of common shares or ADSs as of the date hereof. This discussion applies only to a beneficial owner of common shares or ADSs that is a “U.S. holder”. As used herein, the term “U.S. holder” means a beneficial owner of a common share or ADS that, for U.S. federal income tax purposes, is:

- an individual who is a citizen or resident of the United States;
- a corporation (or other entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States any state thereof or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust if it (1) is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) has a valid election in effect under applicable U.S. Treasury Department regulations to be treated as a U.S. person.

If a partnership (or other entity treated as a partnership for U.S. federal income tax purposes) holds common shares or ADSs, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. A U.S. holder that is a partner of a partnership holding common shares or ADSs should consult its tax advisors.

Except where noted, this discussion deals only with common shares or ADSs held as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended, or the Code, and does not deal with U.S. holders that may be subject to special U.S. federal income tax rules, such as dealers in securities or currencies, traders in securities that elect to use a mark-to-market method of accounting for their securities holdings, banks or other financial institutions, tax-exempt organizations, insurance companies, real estate investment trusts, regulated investment companies, persons holding common shares or ADSs as part of a hedging, integrated, conversion or constructive sale transaction or a straddle, persons liable for alternative minimum tax, pass-through entities and investors in a pass-through entity, persons owning 10% or more of our voting stock, or persons whose "functional currency" is not the U.S. dollar.

This discussion is based upon the provisions of the Code, and existing and proposed U.S. Treasury Department regulations, administrative pronouncements of the Internal Revenue Service, or the IRS, and judicial decisions as of the date hereof. Such authorities may be repealed, revoked or modified so as to result in U.S. federal income tax consequences different from those discussed below, possibly with retroactive effect. In addition, this discussion is based, in part, upon representations made by the Depositary to us and assumes that the deposit agreement, and all other related agreements, will be performed in accordance with their terms.

Except as specifically described below, this discussion assumes that we are not a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. Please see the discussion under "—Passive Foreign Investment Company Rules" below. Further, this discussion does not address the U.S. federal estate and gift, alternative minimum tax, state, local or non U.S. tax consequences of acquiring, holding or disposing of common shares or ADSs.

ADSs

In general, for U.S. federal income tax purposes, U.S. holders of ADSs will be treated as the owners of the underlying common shares that are represented by such ADSs. Deposits or withdrawals of common shares by U.S. holders for ADSs will not be subject to U.S. federal income tax. However, the U.S. Treasury Department has expressed concerns that parties involved in transactions wherein depositary shares are pre released may be taking actions that are inconsistent with the claiming of foreign tax credits by the holders of ADSs. Accordingly, the analysis of the creditability of Brazilian income taxes described herein could be affected by future actions that may be taken by the U.S. Treasury Department.

Taxation of Dividends

The gross amount of distributions paid to a U.S. holder (including amounts withheld by the Brazilian taxing authority, if any, and any payments of interest on shareholders' equity, as described above under "—Brazilian Tax Considerations") will be treated as dividend income to the extent paid out of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Such income generally will be includable in a U.S. holder's gross income as ordinary income when actually or constructively received by the U.S. holder, in the case of common shares, or when actually or constructively received by the Depositary, in the case of ADSs. Such dividends will not be eligible for the dividends received deduction allowed to corporations under the Code. To the extent that the amount of any distribution exceeds our current and accumulated earnings and profits for a taxable year, the distribution will first be treated as a tax free return of capital to the extent of the U.S. holder's adjusted tax basis in the common shares or ADS, causing a reduction in such adjusted tax basis (and thereby increasing the amount of gain, or decreasing the amount of loss, to be recognized on a subsequent disposition of our common shares or ADSs), and thereafter as capital gain recognized on a sale or exchange. Because we do not expect to maintain calculations of earnings and profits in accordance with U.S. federal income tax principles, U.S. holders should expect that a distribution will generally be treated as a dividend for U.S. federal income tax purposes. Distributions of additional common shares or ADSs to U.S. holders that are part of a pro rata distribution to all of our shareholders generally will not be subject to U.S. federal income tax.

The amount of any dividend paid in reais will equal the U.S. dollar value of the reais received calculated by reference to the exchange rate in effect on the date the dividend is received by the U.S. holder, in the case of common shares, or by the Depositary, in the case of ADSs, regardless of whether the reais are converted into U.S. dollars. If the reais received as a dividend are not converted into U.S. dollars on the date of receipt, the U.S. holder will have a tax basis in the reais equal to their U.S. dollar value on the date of receipt. Any gain or loss realized on a subsequent conversion or other disposition of the reais will be foreign currency gain or loss that is treated as U.S. source ordinary income or loss. If dividends paid in reais are converted into U.S. dollars on the day they are received by the U.S. holder or the Depositary, as the case may be, U.S. holders generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. U.S. holders should consult their own tax advisors regarding the treatment of any foreign currency gain or loss if any reais received by the U.S. holder or the Depositary or its agent are not converted into U.S. dollars on the date of receipt.

Certain dividends received by certain non corporate U.S. holders may be eligible for preferential tax rates so long as (1) specified holding period requirements are met, (2) the U.S. holder is not under an obligation (whether pursuant to a

short sale or otherwise) to make related payments with respect to positions in substantially similar or related property, (3) the company paying the dividend is a “qualified foreign corporation” and (4) the company is not a PFIC for U.S. federal income tax purposes, in the year of distribution or the prior year. We do not believe that we were classified as a PFIC for our prior taxable year nor do we expect to be classified as a PFIC for the current taxable year. We generally will be treated as a qualified foreign corporation with respect to our ADSs so long as the ADS remain listed on the NYSE. Based on existing guidance, however, it is not entirely clear whether dividends received with respect to the common shares (to the extent not represented by ADSs) will be eligible for this treatment, because the common shares are not themselves listed on a U.S. exchange. U.S. holders should consult their own tax advisors about the application of this preferential tax rate to dividends paid directly on common shares.

Subject to certain complex limitations and conditions (including a minimum holding period requirement), Brazilian income taxes withheld on dividends, if any, may be treated as foreign income taxes eligible for credit against a U.S. holder's U.S. federal income tax liability. Alternatively, at a U.S. holder's election if it does not elect to claim a foreign income tax credit for any foreign taxes paid during the taxable year, all foreign income taxes paid may instead be deducted in computing such U.S. holder's taxable income. For purposes of calculating the foreign tax credit, dividends paid on our common shares will be treated as income from sources outside the United States. For the purposes of the U.S. foreign tax credit limitations, the dividends paid by us should generally constitute "passive category income" for most U.S. holders. The rules governing the foreign tax credit are complex. U.S. holders should consult their tax advisors regarding the availability of the foreign tax credit under their particular circumstances.

Taxation of Capital Gains

For U.S. federal income tax purposes, a U.S. holder generally will recognize taxable gain or loss on any sale, exchange or other taxable disposition of a common share or ADS in an amount equal to the difference between the U.S. dollar value of the amount realized for the common share or ADS and the U.S. holder's adjusted tax basis in the common share or ADS, determined in U.S. dollars. Such gain or loss will generally be capital gain or loss. The capital gain or loss will be long term capital gain or loss if at the time of sale, exchange or other taxable disposition the U.S. holder has held our common shares or ADSs for more than one year. Capital gains of individuals derived with respect to capital assets held for more than one year are eligible for reduced rates of taxation. The deductibility of capital losses is subject to limitations. Any gain or loss recognized by a U.S. holder will generally be treated as U.S. source gain or loss. Consequently, a U.S. holder may not be able to use the foreign tax credit arising from Brazilian income tax imposed, if any, on the disposition of a common share or ADS unless such credit can be applied (subject to applicable limitations) against U.S. federal income tax due on other income treated as derived from foreign sources. Although we do not believe that U.S. holders will be entitled to a credit or deduction with respect to any IOF tax paid on our common shares (as discussed above in "—Brazilian Tax Considerations—Tax on Financial Transactions (Imposto sobre Operações Financeiras, or IOF)", U.S. holders should, however, be entitled to include the amount of the IOF tax paid as part of their initial tax basis in such common shares.

Passive Foreign Investment Company Rules

Based upon our current and projected income, assets, activities and business plans, we do not expect the common shares or ADSs to be considered shares of a PFIC for our current fiscal year (although the determination cannot be made until the end of such fiscal year), and we intend to continue our operations in such a manner that we do not expect to be classified as a PFIC in the foreseeable future. However, because the determination of whether the common shares or ADSs constitute shares of a PFIC will be based upon the composition of our income, assets and the nature of our business, as well as the income, assets and business of entities in which we hold at least a 25% interest, from time to time, and because there are uncertainties in the application of the relevant rules, there can be no assurance that the common shares or ADSs will not be considered shares of a PFIC for any fiscal year. If the common shares or ADSs were shares of a PFIC for any fiscal year, U.S. holders (including certain indirect U.S. holders) may be subject to adverse tax consequences, including the possible imposition of an interest charge on gains or "excess distributions" allocable to prior years in the U.S. holder's holding period during which we were determined to be a PFIC. If we are deemed to be a PFIC for a taxable year, dividends on our ADSs would not be qualified dividend income eligible for preferential rates of U.S. federal income taxation. In addition, a U.S. holder that owns common shares or ADSs during any taxable year that we are treated as a PFIC would generally be required to file IRS form 8621, as well as comply with additional annual filing requirements imposed under recently enacted legislation. U.S. holders should consult their own tax advisors regarding the application of the PFIC rules (including any information reporting requirements in connection therewith) to the common shares or ADSs.

Information Reporting and Backup Withholding

In general, information reporting requirements will apply to dividends in respect of our common shares or ADSs or the proceeds received on the sale, exchange, or redemption of our ADSs, in each case to the extent treated as being paid within the United States (and in certain cases, outside of the United States) to a U.S. holder unless a U.S. holder establishes its status as an exempt recipient, and backup withholding may apply to such amounts if the U.S. holder does not establish its status as an exempt recipient or fails to provide a correct taxpayer identification number and certify that such U.S. holder is not subject to backup withholding. The amount of any backup withholding from a payment to a U.S. holder will be allowed as a refund or credit against such U.S. holder's U.S. federal income tax liability provided the U.S. holder timely furnishes the required information to the IRS.

In addition, U.S. holders should be aware that recently enacted legislation imposes new reporting requirements with respect to the holding of certain foreign financial assets, including stock of foreign issuers which is not held in an account maintained by a financial institution, if the aggregate value of all of such assets exceeds US$50,000. U.S. holders should consult their own tax advisors regarding the application of the information reporting rules to our common shares and ADSs and the application of the recently enacted legislation to their particular situation.

F. Dividends and Payments Agents

Not applicable.

G. Statements by Experts

Not applicable.

H. Documents on Display

We are subject to the periodic reporting and other informational requirements of the U.S. Securities Exchange Act of 1934, as amended and supplemented, or the Exchange Act. Accordingly, we are required to file reports and other information with the SEC. You may inspect and copy reports and other information filed by us at the public reference facilities maintained by the SEC at 100 F Street, N.W., Washington D.C. 20549. You may obtain copies of these materials upon written request from the Public Reference Section of the Commission at 450 Fifth Street, N.W., Washington D.C. 20549 for certain fees. You may also inspect this material at the offices of the NYSE at 20 Broad Street, New York, New York 10005. In addition to the public reference facilities maintained by the SEC and the NYSE, you may obtain a copy of the annual report, upon written request from the depositary for our ADSs at its corporate trust office located at 101 Barclay Street, New York, New York 10286.

We also furnish to the depositary annual reports in English including audited annual financial statements and unaudited quarterly financial statements in English for each of the first three quarters of the fiscal year. We also furnish to the depositary English translations or summaries of all notices of shareholders' meetings and other reports and communications that are made generally available to holders of common shares.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to various market risks—in particular, foreign currency risk and interest rate risk. We are exposed to foreign currency risk because a substantial portion of our financial indebtedness is denominated in foreign currencies, primarily the U.S. dollar, while we generate all of our net operating revenues in reais. Similarly, we are subject to interest rate risk based upon changes in interest rates, which affect our net financial expenses. For further information on our market risks, see Note 3.1 to our consolidated financial statements.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

A. Debt Securities

Not applicable.

B. Warrants and Rights

Not applicable.

C. Other Securities

Not applicable.

D. American Depositary Shares

In the United States, our common shares trade in the form of ADS. Each ADS represents two common shares, issued by The Bank of New York Mellon, as Depositary pursuant to a Deposit Agreement. The ADSs commenced trading on the NYSE on May 10, 2002.

Fees and Expenses

The following table summarizes the fees and expenses payable by holders of ADRs:

Persons depositing common shares or ADR holders must pay:	**For:**
US$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)	Issuance of ADSs, including issuances resulting from a distribution of common shares or rights or other property Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates
US$0.02 (or less) per ADS (to the extent not prohibited by the rules of any stock exchange on which the ADSs are listed for trading)	Any cash distribution to you
A fee equivalent to the fee that would be payable if securities distributed to you had been common shares and the shares had been deposited for issuance of ADSs	Distribution of securities distributed to holders of deposited securities which are distributed by the depositary to ADR holders
US$0.02 (or less) per ADS per calendar year (to the extent the depositary has not collected a cash distribution fee of $.02 per ADS during the year)	Depositary services

Persons depositing common shares or ADR holders must pay:	**For:**
Registration or transfer fees	Transfer and registration of common shares on our common share register to or from the name of the depositary or its agent when you deposit or withdraw common shares
Expenses of the depositary in converting foreign currency to U.S. dollars	Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)
Expenses of the depositary	
Taxes and other governmental charges the depositary or the custodian have to pay on any ADR or common share underlying an ADR, for example, stock transfer taxes, stamp duty or withholding taxes	As necessary

Any charges incurred by the depositary or its agents for servicing the deposited securities	No charges of this type are currently made in the Brazilian market

Payment of Taxes

The depositary may deduct the amount of any taxes owed from any payments to you. It may also sell deposited securities, by public or private sale, to pay any taxes owed. You will remain liable if the proceeds of the sale are not sufficient to pay the taxes. If the depositary sells deposited securities, it will, if appropriate, reduce the number of ADSs to reflect the sale and pay to you any proceeds, or send to you any property, remaining after it has paid the taxes.

Reimbursement of Fees

The Bank of New York Mellon, as depositary, has agreed to reimburse us for expenses we incur that are related to establishment and maintenance expenses of the ADS program. The depositary has agreed to reimburse us for our continuing annual stock exchange listing fees. The depositary has also agreed to pay the standard out-of-pocket maintenance costs for the ADRs, which consist of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of United States federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls. It has also agreed to reimburse us annually for certain investor relationship programs or special investor relations promotional activities. In certain instances, the depositary has agreed to provide additional payments to us based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depositary collects from investors.

The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deduction from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

Reimbursement of Fees Incurred in 2011

From January 1, 2011 until December 31, 2011, the Company received from the depositary US$484,895.87 for standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of U.S. Federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls), any applicable performance indicators relating to the ADR facility, underwriting fees and legal fees.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

a) Disclosure Controls and Procedures.

We carried out an evaluation under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer and Investor Relations Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, including those defined in the United States Exchange Act Rule 13a-15(e), as of the year ended December 31, 2011.

As a result of this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were both designed and effective at the reasonable assurance level as of December 31, 2011, that the information required to be disclosed in our filings and submissions under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified by the SEC's rules and forms, and that this information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer and Investor Relations Officer, as appropriate to allow timely decisions regarding required disclosure.

b) Management's Report on Internal Control over Financial Reporting

Our management's annual report on internal control over financial reporting is included in this annual report on page F-2.

c) Attestation Report of the Registered Public Accounting Firm

The opinion by our independent registered public accounting firm on the effectiveness of our internal control over financial reporting is included in the report of PricewaterhouseCoopers Auditores Independentes that is included in this annual report on page F-3.

d) Changes in internal control over financial reporting

There have been no changes in our internal control over financial reporting that occurred during the fiscal year ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16

A. Audit Committee Financial Expert

At our board meeting held on June 26, 2006, we established an audit committee, as defined under section 3(a)(58) of the Exchange Act. Our board of directors has determined that Jerônimo Antunes qualifies as an "audit committee financial expert" as defined for the purposes of this Item 16A in Item 16 of Form 20-F. Jerônimo Antunes is an "independent director" within the meaning of the SEC rules.

B. Code of Ethics

We have adopted a code of business conduct and ethics, as defined in Item 16B of Form 20-F under the Exchange Act. Our code of business conduct and ethics, called Code of Ethics and Conduct, applies to all of our employees, including our directors, chief executive officer, chief financial officer and chief accounting officer, as well as our suppliers and third-party contractors. Our Code of Ethics and Conduct is available on our web site at http://www.sabesp.com.br at the following location: Investors Relations – Corporate Governance. If we amend the provisions of our Code of Ethics and Conduct, or if we grant any waiver of such provisions, we will disclose the amendment or waiver on our web site at the same address. You can obtain copies of our Code of Ethics and Conduct, without charge, upon request to sabesp.ri@sabesp.com.br.

C. Principal Accountant Fees and Services

PricewaterhouseCoopers Auditores Independentes served as our independent registered public accounting firm for the years ended December 31, 2009, 2010 and 2011.

The following table presents the aggregate fees for professional services and other services rendered to us by PricewaterhouseCoopers Auditores Independentes in 2010 and 2011:

	Year ended December 31,	
	2010	**2011**
	(in millions of *reais*)	
Audit Fees(1)	2.6	3.9
Audit-Related Fees	-	-
Tax Fees	-	-
All Other Fees	-	-
Total	2.6	3.9

(1) Audit Fees are the fees billed by PricewaterhouseCoopers for the audit of our annual financial statements, reviews of interim financial statements and attestation services that are provided in connection with statutory and regulatory filings or engagements.

Pre-approval policies and procedures

Pursuant to Brazilian law, our board of directors is responsible, among other matters, for the selection, dismissal and oversight of our independent registered public accounting firm. Our management is required to obtain the board of directors' approval before engaging an independent registered public accounting firm to provide any audit or permitted non-audit services to us. The Brazilian Federal and State Public Bidding Laws also apply to us with respect to obtaining services from third parties for our business, including the services provided by our independent registered public accounting firm. As part of the bidding process, the independent registered public accounting firm is required to submit proposals, and are then selected by us based on certain criteria including technical expertise and cost.

During 2010 and 2011, PricewaterhouseCoopers Auditores Independentes did not provide non-audit services to us.

D. Exemptions from the Listing Standards for Audit Committees

None.

E. Purchases of Equity Securities by Issuer and Affiliated Purchasers

Not applicable.

F. Change in Registrant's Certifying Accountant

Not applicable.

G. Corporate Governance

Significant Differences between our Corporate Governance Practices and NYSE Corporate Governance Standards

We are subject to the NYSE corporate governance listing standards. As a foreign private issuer, the standards applicable to us are considerably different than the standards applied to U.S. listed companies. Under the NYSE rules, we are required only to: (a) have an audit committee or audit board, pursuant to an applicable exemption available to foreign private issuers, that meets certain requirements, as discussed below, (b) provide prompt certification by our chief executive officer of any material non-compliance with any corporate governance rules, and (c) provide a brief description of the significant differences between our corporate governance practices and the NYSE corporate governance practice required to be followed by U.S. listed companies. The discussion of the significant differences between our corporate governance practices and those required of U.S. listed companies follows below.

Majority of Independent Directors

The NYSE rules require that a majority of the board must consist of independent directors. Independence is defined by various criteria, including the absence of a material relationship between the director and the listed company. Brazilian law does not have a similar requirement. Under Brazilian law, neither our board of directors nor our management is required to test the independence of directors before their election to the board. However, both the Brazilian Corporate Law and the CVM have established rules that require directors to meet certain qualification requirements and that address the compensation and duties and responsibilities of, as well as the restrictions applicable to, a company's executive officers and directors. Our board of directors must have a minimum of five members and 20% of the board (even if the board consists of greater than five members) must be independent as defined under Novo Mercado Regulations. Currently, three of our ten directors are independent, pursuant to the Novo Mercado Listing Regulations. We believe these rules provide adequate assurances that our directors are independent; however, they do not require that we have a majority of independent directors, as required under the NYSE rules.

Executive Sessions

NYSE rules require that the non-management directors must meet at regularly scheduled executive sessions without management present. The Brazilian Corporate Law does not have a similar provision. According to the Brazilian Corporate Law, up to one-third of the members of the board of directors can be elected from management. There is no requirement that non-management directors meet regularly without management. Our chairperson and Chief Executive Officer is a member of our board of directors. All other members of our Board of Directors meet the NYSE's definition of "non-management" directors. The non-management directors on our board do not typically meet in executive session. Our board of directors consists of ten non-management directors.

Fiscal Committee

Under the Brazilian Corporate Law, the *Conselho Fiscal*, or fiscal committee, is a corporate body independent of management and a company's external auditors. The fiscal committee may be either permanent or non-permanent, in which case it is appointed by the shareholders to act during a specific fiscal year. A fiscal committee is not equivalent to, or comparable with, a U.S. audit committee. The primary responsibility of the fiscal committee is to review management's activities and a company's financial statements, and to report its findings to a company's shareholders. The Brazilian Corporate Law requires fiscal committee members to receive as remuneration at least 10% of the

average annual amount paid to a company's executive officers. The Brazilian Corporate Law requires a fiscal committee to be composed of a minimum of three and a maximum of five members and their respective alternates.

Under the Brazilian Corporate Law, the fiscal committee may not contain members that (i) are on our board of directors, (ii) are on the board of executive officers, (iii) are employed by us or a controlled company, or (iv) are spouses or relatives of any member of our management, up to the third degree.

Our fiscal committee consists of five members and five alternates and the members meet once a month.

Audit Committee

NYSE rules require that listed companies have an audit committee that (i) is composed of a minimum of three independent directors who are all financially literate, (ii) meets the SEC rules regarding audit committees for listed companies, (iii) has at least one member who has accounting or financial management expertise and (iv) is governed by a written charter addressing the committee's required purpose and detailing its required responsibilities. However, as a foreign private issuer, we need only to comply with the requirement that the audit committee meet the SEC rules regarding audit committees for listed companies to the extent compatible with Brazilian Corporate Law. Our audit committee, which is not equivalent to, or comparable with, a U.S. audit committee, provides assistance to our board of directors on matters involving accounting, internal controls, financial reporting and compliance. The audit committee recommends the appointment of our independent auditors to our board of directors and reviews the compensation of our independent auditors and helps coordinate their activities. It also evaluates the effectiveness of our internal financial and legal compliance controls. The audit committee comprises three members elected by the board of directors for a one-year term with the right to re-election, all three of which are independent. The current members of our audit committee are Jerônimo Antunes, Reinaldo Guerreiro and Heraldo Gilberto de Oliveira. All members meet the independent membership requirements of the SEC and NYSE as well as other NYSE requirements. Jerônimo Antunes is the committee's "financial expert" within the scope of the SEC rules covering the disclosure of financial experts on audit committees in periodic filings pursuant to the U.S. Securities Exchange Act of 1934.

Nomination/Corporate Governance and Compensation Committees

NYSE rules require that listed companies have a nominating/corporate governance committee and a compensation committee composed entirely of independent directors and governed by a written charter addressing the committee's required purpose and detailing its required responsibilities. Required responsibilities for the nominating/corporate governance committee include, among other things, identifying and selecting qualified board member nominees and developing a set of corporate governance principles applicable to the company. Required responsibilities for the compensation committee include, among other things, reviewing corporate goals relevant to the chief executive officer's compensation, evaluating the chief executive officer's performance, approving the chief executive officer's compensation levels and recommending to the board non-chief executive officer compensation, incentive-compensation and equity-based plans.

We are not required under applicable Brazilian law to have a nomination/corporate governance committee or compensation committee. Under the Brazilian Corporate Law, the total amount available for compensation of our directors and executive officers and for profit-sharing payments to our executive officers is established by our shareholders at the annual general meeting. The board of directors is then responsible for determining the individual compensation and profit-sharing of each executive officer, as well as the compensation of our board and committee members. In making such determinations, the board reviews the performance of the executive officers, including the performance of our chief executive officer, who typically excuses himself from discussions regarding his performance and compensation.

Shareholder Approval of Equity Compensation Plans

NYSE rules require that shareholders be given the opportunity to vote on all equity compensation plans and material revisions thereto, with limited exceptions. We do not currently have any equity compensation plan. If such a plan were to be implemented, there is no requirement under Brazilian Corporate Law for the plan to be approved by our shareholders. However, if the issuance of new shares in connection with any equity compensation plan exceeded the authorized capital under our bylaws, the increase in capital would require shareholder approval.

Corporate Governance Guidelines

NYSE rules require that listed companies adopt and disclose corporate governance guidelines. We are in compliance with the adoption of corporate governance provisions and guidelines required under the Novo Mercado Regulations. Additionally, under the CVM's guidelines, we have established (i) the Policy of Publicizing Acts or Relevant Facts and the Preservation of Confidentiality which requires us to publicly disclose all relevant information and (ii) the Securities Negotiation Policy which requires management to inform the CVM and the BM&FBOVESPA of any purchases or sales of our securities. We believe the corporate governance guidelines applicable to us under the Novo Mercado Regulations, as well as the CVM, do not conflict with the guidelines established by the NYSE. Our corporate governance guidelines and practices are available in our website at www.sabesp.com.br and in our annual management report.

Code of Business Conduct and Ethics

NYSE rules require that listed companies adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. Applicable Brazilian law does not have a similar requirement. We have decided to adopt and disclose a code of ethics and conduct applicable to all our officers, directors and employees. The adoption and disclosure of a formal code is not required under the Brazilian Corporate Law. We believe our formal code addresses the matters required to be addressed by the applicable NYSE and SEC rules.

Internal Audit Function

NYSE rules require that listed companies maintain an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management processes and system of internal control. Our internal audit department is under the supervision of our Chief Executive Officer and our audit committee and is responsible for our compliance with the requirements of Section 404 of the U.S. Sarbanes Oxley Act of 2002 regarding internal control over financial reporting. Our internal audit department reports to our chief executive officer and the audit committee.

PART III

ITEM 17. FINANCIAL STATEMENTS

We have responded to Item 18 in lieu of responding to this Item.

ITEM 18. FINANCIAL STATEMENTS

The following financial statements, together with the Report of Independent Registered Public Accounting Firms, are filed as part of this annual report. See "Index to Consolidated Financial Statements."

ITEM 19. EXHIBITS

Item	Description
1.1	By-laws of the Registrant (English translation) (incorporated by reference to the Form 6-K filed on April 27, 2012).
4.1	Agreement between the Registrant and the State Department of Water and Energy (*Departamento de Águas e Energia Elétrica—DAEE*), dated April 24, 1997 (English translation) (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form F-1 filed on April 8, 2002 (the "April 8, 2002 Form F-1").
4.2	Protocol of Understanding between the Registrant and the State of São Paulo, dated September 30, 1997 (English translation) (incorporated by reference to Exhibit 10.2 to the April 8, 2002 Form F-1).
4.3	Agreement between the Registrant and the State of São Paulo, through the Secretariat of Finance, dated September 10, 2001 (English translation) (incorporated by reference to Exhibit 10.3 to the April 8, 2002 Form F-1).
4.4	Agreement between the Registrant and the State of São Paulo, through the Secretariat of the Treasury, dated December 11, 2001 (English translation) (incorporated by reference to Exhibit 10.4 to the April 8, 2002 Form F-1).
4.5	Amendment to the Agreement, dated April 24, 1997, between the Registrant and the DAEE, dated March 16, 2000 (English translation) (incorporated by reference to Exhibit 10.5 to the April 8, 2002 Form F-1).
4.6	Amendment to the Agreement, dated April 24, 1997, between the Registrant and the DAEE, dated November 21, 2001 (English translation) (incorporated by reference to Exhibit 10.6 to the April 8, 2002 Form F-1).
4.7	First Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated March 22, 2004. (English Translation) (incorporated by reference to Exhibit 4.7 to the Form 20-F filed on June 28, 2004).

4.8	Second Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated December 28, 2007. (English Translation) (incorporated by reference to the Form 6-K filed on February 25, 2008).
4.9	Third Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated November 17, 2008. (English Translation) (incorporated by reference to the Form 6-K filed on December 23, 2008).
4.10	Commitment Agreement, between the Registrant and the State of São Paulo, dated March 26, 2008. (English Translation) (incorporated by reference to the Form 6-K filed on April 28, 2008).

Item	Description
4.11	Agreement Executed between the Registrant and the São Paulo City Government, dated November 14, 2007 (English Translation) (incorporated by reference to the Form 6-K filed on March 12, 2008).
4.12	Amendment to the Agreement Executed between the Registrant and the São Paulo City government, dated February 10, 2008 (English Translation) (incorporated by reference to the Form 6-K filed on May 12, 2008).
4.14	The Audit Committee Charter dated February 11, 2010 (English Translation) (incorporated by reference to the Form 6-K filed on April 20, 2010).
4.15	Convention between the State and the city of São Paulo, dated June 23, 2010, with the intermediation and consent of the Registrant and of the ARSESP (English Translation) (incorporated by reference to the Form 6-K filed on July 13, 2010).
4.16	Contract to provide public water supply and sewage services, among the Registrant, the State and the city of São Paulo, dated June 23, 2010 (English Translation) (incorporated by reference to the Form 6-K filed on July 13, 2010).
11.1	Code of Ethics and Conduct dated January 26, 2006 (English Translation) (incorporated by reference to the Form 6-K filed on July 7, 2008).
12.1	Certification of Dilma Seli Pena, Chief Executive Officer, pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
12.2	Certification of Rui de Britto Álvares Affonso, Chief Financial Officer and Investor Relations Officer, pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
13.1	Certification of Dilma Seli Pena, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.
13.2	Certification of Rui de Britto Álvares Affonso, Chief Financial Officer and Investor Relations Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

COMPANHIA DE SANEAMENTO BÁSICO DO ESTADO DE SÃO PAULO - SABESP

By: _____
Name: Dilma Seli Pena
Title: Chief Executive Officer

By: _____
Name: Rui de Britto Álvares Affonso
Title: Chief Financial Officer and Investor Relations Officer

Date: June 22, 2012

Companhia de Saneamento
Básico do Estado de São Paulo -
SABESP

IFRS Consolidated Financial Statements

as of and for the years ended

December 31, 2011 and 2010

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Management Report on Internal Control over Financial Reporting

The management of Companhia de Saneamento Básico do Estado de São Paulo - SABESP ("Company" or "SABESP") is responsible for establishing and maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting as defined in Rules 13a-15(f) under the U.S. Exchange Act Rule.

The Company's internal control over financial reporting is a process designed by, or under the supervision of, the Company's Chief Executive Officer and Chief Financial Officer and effected by the Company's Board of Directors, Audit Committee, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect material misstatements on a timely basis. Therefore even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission - COSO. Based on that assessment, management has concluded that as of December 31, 2011, the Company's internal control over financial reporting is effective. As a result of this evaluation, the principal executive officer and principal financial officer of the Company concluded that its disclosure controls and procedures were both designed and effective at the reasonable assurance level as of December 31, 2011.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2011 has been audited by PricewaterhouseCoopers Auditores Independentes, an independent registered public accounting firm, as stated in their report which appears herein.

_____

/S/ Dilma Seli Pena

Chief Executive Officer

March 23, 2012

_____

/s/ Rui de Britto Álvares Affonso

Chief Financial Officer and

Investor Relations Officer

March 23, 2012

Report of Independent Registered

Public Accounting Firm

To the Board of Directors and Shareholders of

Companhia de Saneamento Básico do Estado de São Paulo - SABESP

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in equity and of cash flows present fairly, in all material respects, the financial position of Companhia de Saneamento Básico do Estado de São Paulo - SABESP at December 31, 2011 and December 31, 2010, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2011 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and International Standards of Auditing. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

São Paulo, Brazil

March 23, 2012

/s/ PricewaterhouseCoopers

Auditores Independentes

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Companhia de Saneamento Básico

do Estado de São Paulo - SABESP

Consolidated Balance Sheets as of December 31, 2011 and 2010

Amounts in thousands of reais

Assets	Note	December 31, 2011	December 31, 2010	Liabilities and equity
Current assets				Current liabilities
Cash and cash equivalents	5	2,149,989	1,989,179	Accounts payable to suppliers and contractors
Restricted cash	6	99,729	302,570	Services payable
Customer accounts receivable, net	7	1,072,659	971,318	Current portion of long-term loans and financing
Accounts receivable from related party, net	8	185,333	137,772	Accrued payroll and related charges
Inventories		44,611	36,096	Other taxes payable
Taxes recoverable		118,116	108,675	Interest on shareholders' equity payable
Other assets		55,396	44,511	Provisions
				Other liabilities
Total current assets		3,725,833	3,590,121	
				Total current liabilities
Noncurrent assets				
Customer accounts receivable, net	7	333,713	352,839	Noncurrent liabilities
Accounts receivable from related party, net	8	170,288	231,076	Loans and financing
Indemnities receivable	9	60,295	146,213	Other taxes payable
Escrow deposits		54,178	43,543	Accrued taxes on revenues
Deferred income taxes	14	179,463	78,440	Provisions
Investments property		52,585	-	Pension obligations
Intangible assets, net	10	20,141,677	18,546,836	Other liabilities
Property, plant and equipment, net	11	356,468	249,606	
Other assets		140,484	111,910	Total noncurrent liabilities
Total noncurrent assets		21,489,151	19,760,463	Total liabilities
				Equity
				Capital stock
				Capital reserve
				Earnings reserves and retained earnings
				Total equity

Total assets	25,214,984	23,350, 584	Total equity and liabilities

The accompanying notes are an integral part of these financial statements.

Companhia de Saneamento Básico

do Estado de São Paulo - SABESP

Consolidated Statements of Income

Years Ended December 31, 2011, 2010 and 2009

Amounts in thousands of reais, unless otherwise indicated

	Note	2011	2010	2009
Continuing operations:				
Net revenue from sales and services	20	9,941,637	9,231,027	8,579,519
Cost of sales and services	21	(6,030,977)	(5,194,548)	(5,087,254)
Gross profit		3,910,660	4,036,479	3,492,265
Selling expenses	21	(619,542)	(712,946)	(610,422)
Administrative expenses	21	(846,593)	(653,200)	(717,100)
Other operating income (expenses), net	23	(90,138)	1,830	(44,425)
Operating profit		2,354,387	2,672,163	2,120,318
Financial expenses	22	(702,766)	(789,467)	(765,197)
Financial income	22	465,926	343,914	226,782
Inflation adjustment and foreign exchange result, net	22	(396,801)	66,146	528,449
Financing cost, net		(633,641)	(379,407)	(9,966)
Profit before income tax and social contribution		1,720,746	2,292,756	2,110,352
Income tax and social contribution				
Current	14	(598,303)	(697,115)	(748,708)
Deferred	14	100,976	34,806	146,103
		(497,327)	(662,309)	(602,605)
Net income for the year				
attributable to the Company's shareholders		1,223,419	1,630,447	1,507,747
Earnings per share - basic and diluted (in *reais*)	18	5.37	7.16	6.62

The Company does not have cumulative comprehensive income; therefore, the statement of comprehensive income has not been presented in the consolidated financial statements

The accompanying notes are an integral part of these financial statements.

Companhia de Saneamento Básico

do Estado de São Paulo - SABESP

Statements of Changes in Equity

as of December 31, 2011, 2010, and 2009

Amounts in thousands of reais unless otherwise indicated

		Attributable to owners of the parent						
				Earnings reserves				
	Note	Capital stock	Capital reserve	Legal reserve	Investments reserve	Additional proposed dividend	Retained earnings (losses)	Total
Balances as of December 31, 2008		6,203,688	824,255	309,832	687,219	-	-	7,324,994
Comprehensive income								
Net income for the year		-	-	-	-	-	1,507,747	1,507,747
Total comprehensive income		-	-	-	-	-	1,507,747	1,507,747
Transactions with owners								
Allocation to legal reserve	17(e)	-	-	68,694	-	-	(68,694)	-
Interest on shareholders' equity (R$ 1.73 per share)	17(c)	-	-	-	-	-	(394,157)	(394,157)
Allocation to investments reserve		-	-	-	1,044,896	-	(1,044,896)	-
Total transactions with owners		-	-	68,694	1,044,896	-	(1,507,747)	(394,157)
Balances as of December 31, 2009		**6,203,688**	**824,255**	**378,526**	**1,732,115**	**-**	**-**	**8,438,584**

Comprehensive income								
Net income for the year							1,630,447	1,630,447
Total comprehensive income		-	-	-	-	-	1,630,447	1,630,447
Transactions with owners								
Allocation to legal reserves	17 (e)	-	-	81,522	-	-	(81,522)	-
Interest on shareholders' equity (R$ 1.70 per share)	17 (c)	-	-	-	-	-	(387,231)	(387,231)
Additional proposed dividends		-	-	-	-	68,761	(68,761)	-
Allocation to investments reserve		-	-	-	1,092,933	-	(1,092,933)	-
Total transactions with owners		-	-	81,522	1,092,933	68,761	1,630,447	(387,231)
Balances as of December 31, 2010		**6,203,688**	**824,255**	**460,048**	**2,825,048**	**68,761**	**-**	**9,681,800**
Comprehensive income								
Net income for the year		-	-	-	-	-	1,223,419	1,223,419
Total comprehensive income		-	-	-	-	-	1,223,419	1,223,419
Transactions with owners								
Allocation to legal reserves	17 (e)	-	-	61,171	-	-	(61,171)	-
Distributed dividends of 2010	17 (c)	-	-	-	-	(68,761)	-	(68,761)
Interest on shareholders' equity (R$ 1.27 per share)	17 (c)	-	-	-	-	-	(290,562)	(290,562)
Additional proposed dividends		-	-	-	-	288,143	(288,143)	-
Allocation to investments reserve		-	-	-	583,543	-	(583,543)	-
Total transactions with owners		-	-	61,171	583,543	288,143	1,223,419	(373,917)
Balances as of December 31, 2011		**6,203,688**	**824,255**	**521,219**	**3,408,591**	**288,143**	**-**	**10,545,896**

The accompanying notes are an integral part of these financial statements.

Companhia de Saneamento Básico

do Estado de São Paulo - SABESP

Consolidated Statements of Cash Flows

Years Ended December 31, 2011, 2010, and 2009

Amounts in thousands of reais unless otherwise indicated

	Note	2011	2010	2009
Profit before income tax and social contribution		1,720,746	2,292,756	2,110,352
Adjustments for:				
Depreciation and amortization		768,769	552,184	562,236
Losses on disposal of property, plant and equipment and intangible assets		56,548	16,385	23,372
Allowance for doubtful accounts expense		289,589	402,694	308,188
Change in provisions		614,993	352,614	596,543
Interest on loans and financing		439,117	450,297	395,897
Foreign exchange and monetary (gains) losses on loans and financing		442,954	21,139	(535,409)
Indemnities Receivable		85,918	-	-
Interest and inflation adjustment gains		(2,167)	(55,804)	(14,252)
Provision from São Paulo agreement		15,386	80,368	-
Provision for defined contribution plan		(8,746)	32,587	-
Fair value margin on intangible assets arising from concession contracts		(47,589)	(49,603)	(30,145)
Other adjustments		4,833	19,331	8,197
Adjusted net income		4,380,351	4,114,948	3,424,979
Changes in assets				
Customer accounts receivable		(358,516)	(245,683)	(285,854)
Accounts receivable from related party		20,455	36,708	91,547
Inventories		(8,519)	3,484	6,758
Taxes recoverable		(62,149)	(157,916)	(24,491)
Indemnities receivable		-	-	2,581
Escrow deposits		573	(14,864)	(34,009)
Other assets		(43,025)	(30,508)	3,444
Changes in liabilities				
Accounts payable to suppliers and contractors		145,451	(66,087)	(15,249)
Services payable		87,944	55,678	48,533
Accrued payroll and related charges		(49,582)	(17,525)	43,077
Other taxes payable		(14,649)	(8,316)	(19,505)

Accrued taxes on revenues	1,995	(7,455)	(8,792)
Provisions	(197,521)	(330,256)	(240,032)
Pension obligations	(11,268)	(15,881)	88,549
Other liabilities	150,855	118,774	190,277
Changes in assets and liabilities	(337,956)	(679,847)	(153,166)
Cash generated from operations	4,042,395	3,435,101	3,271,813

The accompanying notes are an integral part of these financial statements.

Companhia de Saneamento Básico

do Estado de São Paulo - SABESP

Consolidated Statements of Cash Flows

Years Ended December 31, 2011, 2010, and 2009

Amounts in thousands of reais unless otherwise indicated (Continued)

	Note	2011	2010	2009
Cash generated from operations				
Interest paid		(736,853)	(618,600)	(555,573)
Income tax and social contribution paid		(588,484)	(733,452)	(643,788)
Net cash generated from operating activities		**2,717,058**	**2,083,049**	**2,072,452**
Cash flows from investing activities				
Restricted cash		202,841	(189,820)	(10,748)
Purchases of property, plant and equipment		(143,684)	(87,383)	(9,347)
Purchases of intangible assets		(2,067,435)	(1,814,166)	(1,973,096)
Proceeds from sale of property, plant and equipment		-	-	29,161
Net cash used in investing activities		**(2,008,278)**	**(2,091,369)**	**(1,964,030)**
Cash flows from financing activities				
Loans and financing				
Proceeds from borrowings		1,854,052	3,425,417	2,237,056
Repayments of borrowings		(1,979,099)	(1,800,507)	(1,896,480)
Payment of interest on shareholders' equity		(422,923)	(398,419)	(303,722)
Net cash provided by (used in) financing activities		**(547,970)**	**1,226,491**	**36,854**
Increase in cash and cash equivalents		**160,810**	**1,218,171**	**145,276**
Cash and cash equivalents at beginning of year	5	1,989,179	771,008	625,732
Cash and cash equivalents at end of year	5	2,149,989	1,989,179	771,008
Increase in cash and cash equivalents		**160,810**	**1,218,171**	**145,276**
Additional information				

Interest and other charges capitalized	261,886	228,899	51,625

The accompanying notes are an integral part of these financial statements.

Companhia de Saneamento Básico

do Estado de São Paulo - SABESP

Notes to the Consolidated Financial Statements

Amounts in thousands of reais, unless otherwise indicated

1 Operations

Companhia de Saneamento Básico do Estado de São Paulo ("SABESP" or the "Company") is a mixed-capital company headquartered in São Paulo, controlled by the São Paulo State Government. The Company is engaged in the provision of basic and environmental sanitation services in the State of São Paulo, and supplies treated water on a wholesale basis.

In addition to providing basic sanitation services in the State of São Paulo, SABESP may perform these activities in other states and countries, and can operate in drainage, urban cleaning, solid waste handling and energy markets. The objective set in the new vision of SABESP is to be recognized as the company that ensured universal access to water and sewage services in its marketplace, focused on the customer, and in a sustainable and competitive manner, with excellence in environmental solutions.

On December 31, 2011, the company operates water and sewage services in 363 of municipalities of the State of São Paulo, having temporarily discontinued operations in the municipalities of Araçoiaba da Serra, Iperó, Cajobi, Alvaro Florense and Macatuba, due to judicial orders under ongoing lawsuits. Most of these municipalities operations are based on 30-year concession agreements. As of December 31, 2011, 99 concessions had expired and are being negotiated. From 2012 to 2033, 39 concessions will expire, and the remaining concessions operate on rollover basis. These concessions with indefinite terms and expired concessions under negotiation are amortized over the useful lives of the underlying assets. By December 31, 2011, the concession program contracts signed totaled 225 (2010 - 201 concession program contracts).

Management believes that all concessions expired and not yet renewed will result in new contracts or contract extensions. Therefore, the risk of discontinuity in the provision of municipal water supply and sewage services was considered remote by Management. As of December 31, 2011, the carrying amount of the underlying assets used in the 99 concessions of the municipalities under negotiation totaled R$ 6,588 million which represents 32.44% of the

total intangible assets and the related gross revenue for the year then ended totaled R$ 2,513 million which represents 23.87% of the total gross revenue.

The Company's operations are concentrated in the municipality of São Paulo, which represents 55.1% of the gross revenues in 2011 (54.7% in 2010).

On June 23, 2010, the State of São Paulo, the Municipality of São Paulo and the Company signed an agreement to share the responsibility for water supply and sewage services to the Municipality of São Paulo based on a 30-year concession agreement. This agreement is extendable for another 30 years. This agreement sets forth SABESP as the exclusive service provider and designates Agência Reguladora de Saneamento e Energia ("ARSESP") as regulator, establishing prices, controlling and monitoring services.

Also, on June 23, 2010, the State of São Paulo, the city of São Paulo and SABESP signed the "Public service provision agreement of water supply and sewage services", a 30-year concession agreement which is extendable for another 30 years. This agreement involves the following activities:

(i) protection of the sources of water in collaboration with other agencies of the State and the City;

(ii) capture, transport and treat of water;

(iii) collect, transport, treatment and final dispose of sanitary sewage; and

(iv) adoption of other actions of basic and environmental sanitation.

In the municipality of Santos, in the Baixada Santista region, which has a significant population, the Company operates under an authorization by public deed, a situation similar to other municipalities in that region and in the Ribeira valley, where the Company started to operate after the merger of the companies that formed it.

On January 5, 2007, Law 11,445 was enacted, establishing the basic sanitation regulatory framework, providing for the nationwide guidelines and basic principles for the provision of such services, such as social control, transparency, the integration authority of sanitation infrastructure, water resources management, and the articulation between industry policies and public policies for urban and regional development, housing, suppression of poverty, promotion of health and environmental protection, and other related issues.

The Company's shares have been listed in the *Novo Mercado* (New Market) segment of BM&FBOVESPA (the São Paulo Stock Exchange) since April 2002 and on the New York Stock Exchange (NYSE) as American Depositary Receipts (“ADRs”) since May 2002.

Since 2008, the Company has been entering in joint venture with other companies, resulting in the following companies: Sesamm, Águas de Andradina, Saneaqua Mairinque, Aquapolo Ambiental, Águas de Castilho e Attend Ambiental. However, SABESP is not the majority stockholder of those companies and the agreement of stockholder consider a power of veto and a quality vote to SABESP, in some subjects, with others stockholders, indicating join control in strategic decisions over those companies. Those companies are considered “joint controlled entities” according to IAS 31.

These financial statements were approved by the Board of Directors on March 22, 2012.

2 Summary of Significant Accounting Practices

2.1 Basis of preparation

The consolidated financial statements of the Company have been prepared in compliance with International Financial Reporting Standards ("IFRS"), issued by the International Accounting Standards Board ("IASB"). These policies have been consistently applied to all the years presented.

The financial statements have been prepared under the historical cost except for certain financial instruments which were measured at fair value according to IFRS.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree to judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are described in Note 4.

2.2 Proportional consolidation

The consolidated financial statements include the financial statements of the Company and its investees: Sesamm – Serviços de Saneamento de Mogi Mirim S/A, Águas de Andradina S.A., Saneaqua Mairinque S.A., Aquapolo Ambiental S.A., Attend Ambiental e Águas de Castilho, which were proportionally consolidated according to the equity interest in these investees.

Companhia de Saneamento Básico

do Estado de São Paulo - SABESP

Notes to the Consolidated Financial Statements

Amounts in thousands of reais, unless otherwise indicated

The Company has no majority shares of its investees, but according to investees' By-Laws approvals of any subject by shareholders in general meeting, except for the approval of any subject mentioned in the investees' By-Laws, which relates to decisions that affect financial and operational policies, for example, approval of the business plan, will be made by a majority vote, and SABESP has power of veto.

For the purposes of calculating the Company's proportional share of revenues, expenses, assets and liabilities of its investees, unrealized gains or transactions between the Company and its investees were eliminated in proportion to the Company's interest; unrealized losses are also eliminated, unless the transaction presents evidence of impairment of the transferred asset. The accounting policies applied by the investees are consistent with the accounting policies adopted by the Company.

Sesamm

On August 15, 2008, the Company, together with the companies OHL Médio Ambiente, Inima S.A.U. Unipersonal ("Inima"), Técnicas y Gestión Medioambiental S.A.U. ("TGM") and Estudos Técnicos e Projetos ETEP Ltda. ("ETEP") incorporated the company Serviços de Saneamento de Mogi Mirim S.A. - SESAMM ("SESAMM"), for a period of 30 years from the date the concession agreement with the municipality of Mogi Mirim for the purpose of providing complementary services to the sewage diversion system and implementing and operating sewage treatment system in the municipality of Mogi Mirim, including the disposal of solid waste.

SESAMM's capital as of December 31, 2011 and 2010, totaled R$ 19,532, and was represented by 19,532,409 registered shares without a par value. SABESP holds 36% of its equity interest and Inima holds another 46% of its equity interest. The Company concluded that both, SABESP and Inima, have joint control over SESAMM. Accordingly, SABESP records their interest over SESAMM applying the proportional consolidation method, equivalent to the 36% of SESAMM's assets and liabilities, revenues and expenses.

As of December 31, 2011, SESAMM´s operations had not been started yet.

Águas de Andradina

On September 15, 2010, the Company, together with the company Companhia de Águas do Brasil – Cab Ambiental incorporated the company Águas de Andradina S.A., with indefinite term, for the purpose of providing water supply and sewage services to the municipality of Andradina.

On December 31, 2011, the capital of Águas de Andradina totaled R$ 2,908, and was represented by 2,908,085 registered shares without a par value. SABESP holds 30%of its equity interest.

The operations started in October 2010.

Saneaqua Mairinque

On June 14, 2010, the Company, together with the company Foz do Brasil S.A. incorporated the company Saneaqua Mairinque S.A., with indefinite term, for the purpose of exploring the public service of water supply and sewage services to the municipality of Mairinque.

On December 31, 2011, the capital of Saneaqua Mairinque totaled R$ 2,000, and was represented by 2,000,000 registered shares without a par value. SABESP holds 30%of its equity interest.

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The operations initiated in October 2010.

Aquapolo

On October 8, 2009, the Company, together with the company Foz do Brasil S.A. incorporated the company Aquapolo Ambiental S.A., for the purpose of producing, providing and commercializing of reused water.

On December 31, 2011, the capital of Aquapolo totaled R$ 36,412, and was represented by 42,419,045 registered shares without a par value. SABESP holds 49%of its equity interest.

The operations are expected to initiate in April 2012.

Águas de Castilho

On October 29, 2010, the Company, together with the company Águas do Brasil – Cab Ambiental, incorporated the company Águas de Castilho, for the purpose of providing water supply and sewage services to the municipality of Castilho.

The capital of Águas de Castilho totaled R$ 622, and was represented by 622,160 registered shares without a par value. SABESP holds 30%of its equity interest.

The operations initiated in January 2011.

Attend Ambiental

On August 23, 2010 the Company Estre Ambiental S.A, incorporated the company Attend Ambiental S.A, for constructing and operating a pretreatment of non domestic effluent station, mud transportation and related services in the city of São Paulo as well as implement similar structures in other areasin Brazil and abroad.

The capital totaled R$ 2,000, and it is represented by 2,000,000 registered shares without a par value. SABESP holds 45%of its equity interest.

The operations initiated in January 2011.

See below a summary of financial information of the joint-controlled entities:

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	2011					
	Sesamm	**Águas de Andradina**	**Águas de Castilho**	**Saneaqua Mairinque**	**Aguapolo Ambiental**	**Attend Ambiental**
	36%	**30%**	**30%**	**30%**	**49%**	**45%**
Current assets	2,658	360	133	561	12,424	5,003
Non-current assets	14,447	1,300	423	164	180,717	223
Current liabilities	832	815	256	228	10,262	127
Non-current liabilities	11,120	84	47	28	167,498	5,130
Stockholders' equity	5,153	761	253	469	15,381	(31)
Operating revenue	9,203	2,985	651	2,498	-	-
Operating expenses	(10,494)	(2,954)	(568)	(2,730)	(1,438)	(992)
Financial income, net	115	31	5	44	-	60
Profit (loss) for the year	(1,176)	62	88	(188)	(1,438)	(932)

	2010			
	Sesamm	**Águas de Andradina**	**Saneaqua Mairinque**	**Aguapolo Ambiental**
	36%	**30%**	**30%**	**49%**
Current assets	420	178	851	13,798
Non-current assets	5,353	106	10	46,094
Current liabilities	2,702	119	177	1,331
Non-current liabilities	-	301	9	53,909

Stockholders' equity	3,071	(136)	675	4,652
Operating revenue	-	247	447	-
Operating expenses	(638)	(451)	(384)	(1.023)
Financial income, net	95	-	12	-
Profit (loss) for the year	(543)	(204)	75	(1.023)

2.3 Segment reporting

IFRS 8 requires that segment report is identified based in internal reporting regularly reviewed by decision-maker in order to define the allocation of resources and evaluate performances.

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Executive Board that makes strategic decisions.

Based in the manner that the Company defines the allocation of resources, two operating segments (water and sewage services) are presented on note 19.

2.4 Translation into foreign currency

(a) Functional and reporting currency

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Items included in the financial statements are measured using the currency of the primary economic environment in which the company operates ("the functional currency"). The financial statements are presented in Brazilian *reais* (R$ or reais), which is also the Company's functional and presentation currency. All financial information presented has been presented in reais, except where indicated.

(b) Foreign currency translation

Foreign currency-denominated transactions are translated into Brazilian *reais* using the exchange rates prevailing at the transaction dates. Balance sheet accounts are translated at the exchange rate prevailing at balance sheet date. Exchange gains and losses arising on the settlement of these transactions and the translation of foreign currency-denominated cash assets and liabilities are recognized in Foreign exchange result in the statement of income.

2.5 Financial Instruments

2.5.1 Classification

The Company classifies its financial assets according to the following categories: measured at fair value through profit or loss, loans and receivables, held-to-maturity and available for sale. The classification depends on the purpose for which the financial assets were recognized at fair value and subsequently acquired. Management determines the classification of the financial assets at inception. As of December 31, 2011 and 2010, the Company had no financial

assets classified in the category held-to-maturity and available for sale.

(a) Financial assets calculated at fair value through profit or loss

These are financial assets held for active and frequent trading. Financial asset is classified in this category if it was acquired to be negotiated in short-term. These assets are classified as current assets. Gains or losses arising from changes in the fair value of financial assets measured at fair value through profit or loss are presented in the statement of income in 'Financial income' or 'Financial expenses' in the period they occur, unless the instrument has been contracted in connection to another transaction. In this case, changes are recognized in the same line item of income affected by this transaction.

(b) Loans and receivables

These comprise receivables which are non-derivative financial assets with fixed or determinable payments, not quoted in an active market. Loans and receivables are presented in current assets or liabilities, except for those with maturity of more than 12 months after the balance sheet date (these are classified as noncurrent assets or liabilities). The Company's loans and receivables include cash and cash equivalent trade accounts receivable, other accounts receivable and loans. Loans and receivables are recognized at fair value e subsequently recorded at amortized cost, under the effective interest rate method.

2.6 Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three month or less.

2.7 Revenue from sales and services

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a) Revenue from sales and services

Revenue from water supply and sewage collection are recognized as the water is consumed and services are provided. Revenues, including the revenues unbilled, are recognized at the fair value of the consideration received or receivable for the sale of those services in the ordinary course of the Company's activities. Revenue is shown net of value-added tax, rebates and discounts. Revenues from unbilled represent incurred revenues in which the services were provided, but not yet billed until the end of the each period. Water supply and sewage services are recorded as trade accounts receivable based on monthly estimates of the completed services.

The Company recognizes revenue when: i) products are delivered or services are rendered; ii) the amount of revenue can be reliably measured, iii) it is probable that future economic benefits will flow to the Company and iv) it is probable that the amounts will be collected. The amount of revenue is not considered to be reliably measurable until all conditions relating to the sale have been satisfied. Amounts in dispute are recognized as revenue when collected.

b) Construction revenue

Revenue from concession construction contracts is recognized in accordance with IAS 11 Construction Contracts using the percentage-of-completion method, provided that the applicable conditions for application are fulfilled. The percentage of completion is calculated from the ratio of the actual costs incurred on the balance sheet date to the planned total costs (cost-to-cost method). Revenue is recognized by reference to the construction costs incurred during the period plus a fee earned. The fee represents the additional margin related to the work performed by the Company in relation to such construction contracts and it is added to the construction costs incurred and the total is recognized

as construction revenue.

2.8 Customer accounts receivable and allowance for doubtful accounts

Customer accounts receivable are amounts due from customers for services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as noncurrent assets.

The Company records an allowance for doubtful accounts for receivable balances in an amount that is deemed by management to be sufficient to cover probable losses in accounts receivable, based on the analysis of the history of receipts and existing warranties, and it does not expect to incur in additional significant losses, mainly in relation to the municipalities.

2.9 Inventories

Inventories of supplies for consumption and maintenance of the water and sewage systems are stated at the lower of average cost of acquisition or realizable value, and are classified in current assets.

2.10 Investment property

The investment property is recognized by the cost of acquisition or the construction cost, less the related accumulated depreciation. The depreciation is calculated by straight line basis considering the useful life of the assets. The maintenance expense is recognized in the profit and loss when occurred.

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The Company held some assets for a currently undetermined future use. The Company is analyzing whether the assets will be used in the operation or will be sold in short-therm.

2.11 Property, plant and equipment

Property, plant and equipment comprise mainly administrative facilities which are not related to the concession contracts. Those assets are stated at historical cost of acquisition or construction less depreciation, net of impairment charge, when necessary, and include interest capitalized incurred during the construction period where applicable, for the qualifying assets.

Subsequent costs included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that the future economic benefit associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they were incurred.

Land is not depreciated. Depreciation is calculated using the straight-line method to allocate their cost and is described in Note 11(a).

The residual amount and the useful life of the underlying assets are reviewed and adjusted, if necessary, in the end of the year.

Gain and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within other operating income (expenses) in the income statements.

2.12 Intangible assets

Intangibles are stated at acquisition cost and/or construction of the underlying assets, including the construction margin, interest and other financial charges capitalized during the construction period, in this case, for the qualifying assets when applicable. Qualifying assets are assets that, necessarily, take a substantial period to get ready for its intended use or sale. The Company considers that substantial period means a period greater than 12 months. This period was established by considering the completion period of the majority of its constructions which is greater than 12 months.

The amortization is calculated when the intangible assets are available for use in the necessary condition established by the Company.

The amortization reflects the period over the expected future economic benefits generated by the intangible asset and can be the period of the contract or the useful life of the underlying assets constructed, what occurs first.

The amortization of the intangible assets finish when the underlying asset is totally consumed or its is alienated, what occurs first.

Infrastructure to which the operator is given access by the grantor of the concession or donation received from third parties is not recognized in the consolidated balance sheet, since such donations are controlled by the concession grantor.

The amount received to construct infrastructures is recognized in the profit and loss as “Other operating income (expenses), net”.

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(a) Concession arrangements

The Company operates concession contracts covering the provision of basic and environmental sanitation services, water supply and sewage services agreed with the concession grantor. The infrastructure used by SABESP subject to service concession arrangements is considered to be controlled by the concession grantor when:

(i) The grantor controls or regulates what services the operator must provide with the infrastructure, to whom it most provide them, and at what price; and

(ii) The grantor controls the infrastructure, i.e., retains the right to take back the infrastructure at the end of the concession.

SABESP's rights over infrastructure operated under concession arrangements is accounted for as an intangible asset as SABESP has the right to charge for use of the infrastructure assets, and users (consumers) have the primary responsibility to pay SABESP for the services.

The fair value of construction and other work on the infrastructure represents the cost of the intangible asset and is recognized as revenue when the infrastructure is built, provided that this work is expected to generate future economic benefits. The account policy for revenue recognition for construction services is detailed on note 2.7 “Revenue from

sales and services".

Intangible assets under Concession contracts and Program contracts, when there is no right to receive the residual value of the assets at the end of the contract, are amortized on a straight-line basis over the period of the contract, or the useful life of the underlying asset, what occurs first.

The investments not recovered in the services provided, during the contract, will be indemnity by the concession grantor, (1) in cash or cash equivalent or (2) extend the contract period. These investments are amortized over the useful life of the assets.

(1) Financial assets are recognized when the Company has the inconditioning right to receive cash or cash equivalent in the end of the contract period, as an indemnity for the investments not recovered in the services provided, during the contract period. The Company did not recognized any financial assets due to the fact that there is no expectation that the Company will receive cash (historically the contracts period are extended);

(2) Continuing the operation, the assets will be maintained in the intangible assets.

(b) Software licenses

Software licensing of computer programs and business management systems acquired are capitalized and amortized over the period of the license and the expenses associated with maintaining these are recognized as expenses when incurred.

2.13 Impairment

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Property and equipment, intangibles and other noncurrent assets, with defined useful life, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The recoverable amount is the higher of value in use and fair value less cost to sell. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. For assets with undefined useful life, so not subject to amortization, it is tested annually, not considering the expectation of loss (impairment). The recoverable amount is the higher between the amount in use and the fair value less the cost to sell. Impairment is recognized in the profit and loss for the amount where the amount of the asset is higher than the recoverable amount. For the purposes of measuring impairment, assets are grouped in the lowest level for which there are separately identifiable cash flows (CGU - Cash Generating Units). The assets adjusted by impairment are reviewed subsequently to analyze the possible reversion of the impairment in the date covered by the financial statements, except for goodwill.

The CGU’s analyzed by the Company to evaluate the recoverable value of the assets were defined according to the business decision-maker. Analyzes are performed by business unit, which consist in a group of municipalities which has cost sharing or are supported by the same hydrological basin.

The methodology applied was the discounted cash flow mainly related to the assets related to the concessions, considering a five-year period operating cash flow. From 2017 until the maturity date of each contract, the operating cash flow is adjusted, annually, by a 4.5% inflation rate and discounted by the weighted average cost of capital (WACC).

The process to estimate the value in use involves premises, judgments and estimates about the future cash flows and represents the best estimates of the Company, approved by the board.

As of December 31, 2011 the Management evaluated that there is no indication that the amounts of property and equipment, intangibles and other noncurrent assets will not be recovered by future operations.

2.14 Accounts payable to suppliers and contractors

Accounts payable to contractors and suppliers are obligations to pay for goods or services purchased from suppliers in the ordinary course of business and are classified as current liabilities if the payment is due in the period up to one year. Otherwise, the accounts payable are presented as non-current liabilities and are initially measured at fair value which generally correspond to the amount billed and subsequently to the amortized cost.

2.15 Loans and financing

Borrowings are initially recognized at fair value, upon receipt of funds, net of transaction costs. Subsequently, borrowings are stated at amortized cost, and interest is accrued based on the effective interest method, as presented in Note 12. Loans and financing are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Nonconvertible debentures are recognized in a similar manner to borrowings.

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2.16 Borrowing costs

Borrowing costs related to acquisition, construction or production of an asset which, necessarily, takes long time to be ready for use or sell are capitalized as cost of the asset. Other costs of the loan are recognized as expenses in the period that it occurs. Borrowing costs are interest and other financial charges over the loan, including exchange rate variation, in the terms described below.

The capitalization occurs during the period of the construction, considering the weighted average rate of the loans in place in the date of the capitalization.

The loans and financing acquired in foreign currency, are analyzed as they were acquired in local currency, and the capitalization of the interest and/or exchange rate variation is limited by the amount which would be capitalized if the loans and financing were acquired in local currency.

2.17 Payroll and related charges

Salaries include an accrual for vacations and the 13th salary and additional payments negotiated in collective labor agreements plus related charges and are recorded on the accruals basis.

2.18 Profit sharing

The Company's profit sharing plan for its employees is based on general targets of the Company as a whole, and based on the performance of each business units. The Company recognizes a provision when has a contract or when there is a prior practice which gave rise to a non formal obligation (constructive obligation). The expense for profit sharing is recorded on the accruals basis as an operating expense and cost of sales and services.

2.19 Provisions, legal obligation, escrow deposits and contingent assets

Provisions for legal claims are recognized when: i) the Company has a present legal or constructive obligation as a result of past events; ii) it is probable that an outflow of resources will be required to settle the obligation; and iii) the amount can be reliably estimated. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

For financial statement presentation purposes, the provisions are stated net of the related escrow deposits based on the legal right to offset. The bases and the nature of the provision for civil, tax, labor and environmental risks are described in Note 15.

Escrow deposits not linked to related liabilities are recorded in noncurrent assets. The escrow deposits are restated according to fiscal authorities.

Legal obligations occur from tax obligation which objective is to claim the legality. The obligations are recognized in the financial statements.

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Contingent assets are not recognized, except when the gain is virtually certain or when there are real warrants or final judicial decision favorable to the Company.

2.20 Environmental costs

Costs related to ongoing environmental programs are expensed as incurred. Ongoing programs are designed to minimize the environmental impact of the operations and to manage the environmental risks inherent to the Company's activities.

2.21 Income taxes and social contribution – current and deferred

The Company adopted a transitory tax regime (RTT) to calculate income tax and social contribution, as enacted by law 11,941/09, considering the account effects by law 6,404/76, before the changes considered in law 11,638/07.

This regime will be in place until a new law be enacted. This regime was optional in 2008 and 2009 and was obliged from 2010 on.

The Company opted for this regime in 2008. Consequently, the Company adopted the rules established in the RTT to December 31, 2011, 2010 and 2009.

The tax expense for the period comprises current and deferred tax.

(a) Current tax

The current income tax and social contribution expense are calculated on the basis of the laws enacted or substantively enacted at the balance sheet date, pursuant to Brazilian tax regulations. Income taxes in Brazil comprise Federal income tax (15%), increased by 10% what exceeded R$240, and social contribution (9%). Taxable income differs from net income (profit presented in the statement of income), because it excludes income and expenses taxable or deductible in other years, and excludes items not permanently taxable or not deductible. Management periodically evaluates and measures the positions taken in the income tax return with respect to situations in which applicable tax regulations are subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

(b) Deferred tax

Deferred income and social contribution taxes are recognized, using the liability method, on temporary differences arising between the tax basis of assets and liabilities and their carrying amounts in the consolidated financial statements, according to IAS 12. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss. Deferred income and social contribution taxes are determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income and social contribution taxes assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

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Deferred income and social contribution taxes assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2.22 Accrued taxes on revenues

Accrued taxes on revenues are recognized on accrual basis for PASEP (Public Servant Fund) and Cofins (Social Security Financing Contribution). These taxes are calculated on differences from tax basis of billing to government entities, which are taxable when the invoices are settled. As these taxes are non-cumulative, they are presented net of tax credits, as deductions from gross revenues. Debts and credits arising from other operating income and expenses, respectively, are presented as deductions from the respective operating income or expense.

2.23 Pension obligations

(a) Defined benefit

Liabilities from defined benefit pension plan obligations correspond to the present value of the defined benefit obligation at balance sheet date, less the fair value of the plan's assets, and adjusted by unrecognized actuarial gains or losses. The defined benefit obligation is calculated on an annual basis by independent actuaries, using the projected unit credit method. The estimated future cash outflows is discounted to its present value, using the interest rates of Government bonds with maturities that approximate the maturity of the related liability.

The Company adopted the corridor approach to recognize the actuarial gains and losses. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are in excess of the greater of 10% of the fair value of plan assets or 10% of the present value of the defined benefit obligation are charged or credited to income over the employees' expected average remaining working lives. The expenses related to pension plan are recognized in profit and loss of the year as cost of sales and services, selling expenses or administrative expenses, according to employee’s allocation.

In a event where a curtailment relates to only some of the employees covered by a plan, or where only part of an obligation is settled, the gain or loss includes a proportionate share of the previously unrecognized past service cost and actuarial gains and losses. The proportionate share is determined on the basis of the present value of the obligations before and after the curtailment or settlement.

The Company pays contributions to an unlisted private pension entity, Fundação Sabesp de Seguridade Social – Sabesprev, in a compulsory basis, contracted or not. The regular contributions consist of the net costs of the plan and are recognized in the profit and loss of the period.

(b) Defined contribution

The Company participates in a defined contribution plan (Sabesprev Mais), controlled by a closed private pension entity – Fundação SABESP de Seguridade Social (Sabesprev) that provide postretirement benefits to the Company´s employees.

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A defined contribution plan is a pension plan under which the Company makes fixed contribution to a closed private pension entity. The Company has no further legal or contractual obligation to provide further contributions in case the pension fund is not sufficient to pay the benefits to all employees related to the service cost of current or prior period.

With respect to the defined contribution plan, the Company contributes to Sabesprev on mandatory, contractual or voluntary basis. The regular contributions are recognized in the income statement of the period.

2.24 Financial income and expenses

Financial income is primarily comprised of interest, inflation adjustments and exchange variations on short term investments and client negotiation. Financial expenses are primarily comprised of interest, inflation adjustments and exchange variations on loans and financing and provisions. These financial income and expenses are calculated using the effective interest rate method.

2.25 Leases

According to IAS 17, leases are classified as financial leases when there is transfer substantially all the risks and rewards incidental to ownership of an asset. Other leases are classified as operational lease. Operational leases are recognized as expenses in the profit and loss on a linear basis during the contract.

Financial leases are recognized based at lower of the present value of the minimum payment of the contract or the fair value of the related asset in the beginning of the contract. The payments are recognized as expenses or reducing the leasing in order to obtain a linear interest rate. The corresponding obligation is recognized as short or long term debt.

2.26 Other current and noncurrent assets and liabilities

Other assets are stated at cost of acquisition, net of any impairment loss, when applicable. The amounts recognized as other liabilities are stated at known or estimated amounts, including, where applicable, related charges and monetary variations.

2.27 Dividends and Interest on Shareholders' Equity

The Company uses the tax benefits of distributing dividends as interest on shareholders' equity, as permitted by Brazilian Law. This distribution of dividend is accounted for in accordance with Brazilian Law 9,249/95 for tax deductibility purposes, limited to the daily pro rata fluctuation of the Long-term Interest Rate (TJLP). The benefit attributed to the shareholders is recognized in the current liability against Equity, based on the articles of association. Dividends and interest on shareholders´ equity over the minimum established in the articles of association are recognized when approved by the shareholders in the general meeting. The tax effects of the interest on shareholders' equity are recognized in the income statement of the year.

2.28 Present value adjustment

Current and noncurrent financial assets and liabilities are adjusted to present value based on discount rate at current market rate as of the transaction date, when the effects are relevant.

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2.29 New and amended standards adopted by the Company

In 2009, the Company has early adopted IAS 24 - Related Party Disclosures (as amended in November 2009). The disclosure requirements for entities that are controlled, jointly-controlled or significantly influenced by a government (referred to as government-related entities) are simplified and so detailed disclosures of all transactions with entities controlled by the São Paulo State Government are not presented in these financial statements.

2.30 Standards, amendments and interpretations to existing standards that are not yet effective

Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company

The following new standards, amendments and interpretations to existing standards were issued by IASB but are not effective for 2011. The early adoption of these standards, even though encouraged by IASB, has not been implemented in Brazil by the Brazilian Accounting Pronouncements Committee (CPC).

. IAS 19, "Employee benefits" was amended in June 2011. The impact on the Group will be as follows: (i) to eliminate the corridor approach; (ii) to recognize all actuarial gains and losses in other comprehensive income as they occur; (iii) to immediately recognize all past service costs; and (iv) to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability (asset). Management is evaluating the total impact of these changes for the Company. The standard is applicable as from January 1, 2013.

. IFRS 9, "Financial instruments" addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortized cost. The determination is made at initial recognition. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial instruments. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the statement of income, unless this creates an accounting mismatch. Management is evaluating the impact of this standard for the Company. The standard is applicable as from January 1, 2013.

. IFRS 10, "Consolidated financial statements" builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control. Management is evaluating the impact of this standard for the Company. The standard is applicable as from January 1, 2013.

. IFRS 11,"Joint arrangements" was issued in May 2011. The standard provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. There are two types of joint arrangements: (i) joint operations - arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses; and (ii) joint ventures - arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. The proportional consolidation method will no longer be permitted in joint ventures. Management is evaluating the impact of this standard for the Company. The standard is applicable as from January 1, 2013.

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. IFRS 12, "Disclosures of interests in other entities" includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. Management is evaluating the impact of this standard for the Company. The standard is applicable as from January 1, 2013.

. IFRS 13, “Fair value measurement” was issued in May 2011. IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The Company is yet to assess IFRS 13’s full impact. The standard is applicable as from January 1, 2013.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Company.

3 Financial Risk Management

3.1 Financial risk factors

The Company's activities expose it to a variety of financial risks: market risk (including foreign currency risk and interest rate risk), credit risk and liquidity risk. The Company analyzes the global risk considering the unpredictability of the financial market and tries to minimize the potential adverse financial impacts.

The Company has not utilized derivative instruments, although it may enter in forward exchange transactions and financing funding transactions in Brazilian *reais* to mitigate the foreign currency exposure.

(a) Market risk

Foreign currency risk

The Company is exposed to exchange rate fluctuations from Brazilian reais to US dollars and Yens. Liabilities in foreign currency include loans in US dollars and Yens.

Depreciation of Brazilian reais comparing to loans in foreign currency will incur in losses related to such liability.

Foreign currency risks to SABESP are related to the exposure of short and long term loans in foreign currency.

SABESP’s foreign currency risk are monitored considering several actual and projected economic factors, beside the market condition. The Company does not have hedge or swap contracts to hedge against this risk. The Company monitors the financial debts to reduce the exposure to exchange rate variation taking advantage of opportunities to exchange expensive debts to cheaper debts by reducing financing costs through early payment of its debts. The priority is to acquire new debts with multilateral banks and official agencies from foreign governments, which are characterized by low cost and long term maturity.

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On December 31, 2011 and 2010, R$ 3,053.4 million and R$2,248.9 million, which correspond to 36.4% and 27.2%, respectively, of the debt of SABESP was denominated in foreign currency. The debts of SABESP denominated in foreign currency were acquired, mainly, with Inter-American Development Bank (IADB). Considering those facts, the Company is exposed to foreign exchange fluctuations which can result in material adverse effects to the business.

The Company's exposure to currency risks are summarized as follows:

	December 31, 2011		December 31, 2010	
	Foreign currency	**R$**	**Foreign currency**	**R$**
Loans and financing - US$	1,113,236	2,088,208	1,084,898	1,807,657
Loans and financing - Yen	39,456,912	959,198	21,316,000	436,978
Debt issuance cost		(13,656)		(10,801)
Interest and other charges		19,671		15,094
Total		3,053,421		2,248,928

As of December 31, 2011, if the Brazilian *rea*l had weakened or strengthened by 10% against the US dollar and Yen with all other variables held constant, post-tax profit for the year and in the shareholders' equity would have been R$ 201,129 (2010 - R$ 148,146) lower or higher, mainly as a result of foreign exchange losses or gains on the translation of foreign currency denominated loans.

	December 31,	December 31,

	2011	2010
Projection of valuation / devaluation of Real by 10%		
Loans and financing	3,047,406	2,244,635
Variation Dolar/ Yen	10%	10%
Valuation or devaluation of Real	304,741	224,464
Income taxes rate	34%	34%
Income taxes	103,612	76,318
Valuation or devaluation net of taxes	201,129	148,146

Interest rate risk

This risk arises from the possibility that the Company could incur losses due to fluctuations in interest rates, increasing the financial expenses related to loans and financing.

On December 31, 2011 and 2010, R$ 2,537.1 million or 29.5% and R$2.529,4 million or 30.6%, respectively, of the debt of SABESP were denominated in Brazilian reais and indexed to UPR (“Unidade Padrão de Referência”, a Reference Standard Unit, which is equal to the TR “Taxa Referencial”, a Reference Rate). On December 31, 2011 and 2010, R$1,882.3 million or 21.9% and R$2,064.7 million or 25.0%, respectively, of the debt of SABESP were denominated in Brazilian reais and indexed to the fluctuation of DI (Interbank Deposit) rate.

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On December 31, 2011 and 2010, R$ 1,152.1 million and R$996.1 million, respectively, of the debt of SABESP were denominated in US dollars and indexed to the fluctuation of rates of Inter-American Development Bank (IADB).

On December 31, 2011 and 2010, the Company has not entered into any derivative contracts to hedge againstthe UPR (Reference Standard Unit), DI (Interbank Deposit) or for IADB (Inter-American Development Bank) rates; however, it continually monitors market interest rates, in order to evaluate the possible need to replace its debt. The Company is obliged to invest the excess of cash in financial institutions controlled by the Federal Government.

The Company invest the excess of cash, which corresponded to R$ 2,031.1 million and R$1,853.2 million, on December 31, 2011 and 2010, respectively, mainly in short term investments. As a result, the exposure of SABESP to interest rate risk is partially limited to the financial gain of such investments, which normally are indexed to the fluctuation of DI (Interbank Deposit) rate.

The Company maintained approximately 28% of its loans and financing in local and foreign currency indexed to fixes rates. During 2011 and 2010, the loans and financing indexed to variable rates were in local and foreign currency.

The table below provides the Company's loans and financing denominated in *reais* subject to variable interest rate:

	December 31, 2011	**December 31, 2010**

UPR[(i)]	2,537,089	2,529,398
CDI[(ii)]	1,882,341	2,064,714
IGP-M[(iii)]	-	493,869
TJLP[(iv)]	886,138	703,710
IPCA[(v)]	187,697	223,996
Fixed rate	49,609	-
Total loans and financing in local currency	5,542,874	6,015,687

(i) UPR (*Unidade Padrão de Referência*), a Reference Standard Unit, which is equal to the TR (*Taxa Referencial*), a Reference Rate.

(ii) CDI (*Certificado de Depósito Interbancário*), an interbank deposit certificate.

(iii) IGP-M *(Índice Geral de Preços do Mercado),* a general market price index.

(iv) TJLP *(Taxa de Juros a Longo Prazo),*a long-term interest rate index.

(v) IPCA *(Índice Nacional de Preços ao Consumidor Amplo*),a consumerprice index.

Another risk to which the Company is exposed, is the mismatch of the monetary restatement indices of its loans and financing with those of its receivables. Water supply and sewage services tariffs do not necessarily follow the increases in the interest rates affecting the Company's indebtedness.

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As of December 31, 2011, if interest rates on loans and financing denominated in Brazilian *reais* had been 100 basis points higher or lower with all other variables held constant, post-tax profit would have been R$ 35,114 (2010 - R$ 39,338) lower or higher, mainly as a result of a lower or higher interest expense on floating rate loans and financing.

(b) Credit risk

Credit risk arises from cash and cash equivalents, deposits in banks and financial institutions, as well as credit exposures to wholesale and retail customers, including outstanding accounts receivable. The Company is required by law to invest its surplus cash with financial institutions controlled by the State Government. Credit risk exposure to retail customers is mitigated by sales to a geographically dispersed customer base. The maximum exposure to credit risk at the reporting date are the amounts of cash equivalents, deposits in banks and financial institutions, wholesale and retail customers in the balance sheet. (See notes 5, 6 and 7).

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates. The credit quality of counterparties which are banks, such as cash and cash equivalents, the Company considers the lower rating of the counterparty published by three mainly international agency of rating (Moody's, Fitch e S&P), according to internal policy of management of market risk:

	December 31, 2011	December 31, 2010
Cash at bank and short term bank deposits		
brAAA	38,058	27,673

brAA+	2,102,304	1,945,697
Others (*)	1,717	14,634
	2,142,079	1,988,004

(*) This category is comprised by banks which have no credit rating information available.

The available credit rating information of the banks in which the Company made transactions during 2011 is as follow:

Banks	**Fitch**	**Moody's**	**Agencies' rate Standard Poor's**
Banco do Brasil S.A.	AA+ (bra)	Aaa.br	brAAA
Banco Santander Brasil S.A.	AAA (bra)	Aaa.br	brAAA
Caixa Economica Federal	AA+ (bra)	Aaa.br	-
Banco Bradesco S.A.	AAA (bra)	Aaa.br	brAAA
Itaú Unibanco Holding S.A.	AAA (bra)	Aaa.br	AAAbr

(c) Liquidity risk

The Company's liquidity is primarily reliant upon cash provided by operating activities, borrowings from Brazilian Federal and State governmental financial institutions, and financing in the domestic and international capital markets. The liquidity risk management considers the assessment of its liquidity requirements to ensure it has sufficient cash to meet operational and capital expenditures needs.

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The excess of cash is invested in short-term investment indexed by interest, deposits held at call with banks, other short-term highly liquid investments considering appropriate maturity date and liquidity.

The table below provides the Company's contractual undiscounted cash flows of the financial liabilities into relevant maturities based on the balance sheet as of December 31, 2011 and 2010.

	2012	**2013**	2014 / 2015 / 2016	from 2017 then on	**Total**
As of December 31, 2011					
Loans and financing	2,115,837	1,689,526	3,008,577	5,162,889	11,976,829
Accounts payable to suppliers and contractor	255,557	-	-	-	255,557
Services payable	383,116	-	-	-	383,116
As of December 31, 2010					
Loans and financing	1,744,324	2,071,161	3,834,599	4,880,026	12,530,110
Accounts payable to suppliers and contractor	144,043	-	-	-	144,043
Services payable	295,172	-	-	-	295,172

There are no financial assets or liabilities included in “Other assets” or “Other liabilities”.

3.2 Capital management

The Company's objectives when managing capital are ensure its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, and to maintain an optimal capital structure to

reduce the cost of capital.

The Company monitors capital based on the leverage ratio. This ratio corresponds to net debt divided by total capital. Net debt corresponds to total loans and financing (including short and long term loan and financing, as presented in the financial statements) less cash and cash equivalents. Total capital is calculated as total equity as shown in the balance sheet plus net debt.

The financial leverage rate on December 31, 2011 and 2010 as summarized below:

	December 31, 2011	**December 31, 2010**
Total loans and financing	8,596,295	8,264,615
Less: cash and cash equivalents	(2,149,989)	(1,989,179)
Net debt	6,446,306	6,275,436
Total equity	10,545,896	9,681,800
Total capital	16,992,202	15,957,236
Leverage ratio	37.9%	39.3%

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In 2010, the Company's leverage ratio decreased to 37.9% as of December 31, 2011, compared to 39.3% as of December 31, 2010, due to increase in short term investments.

The capital is not managed at consolidated level, but only at parent company level, whereas the subsidiaries are not relevant.

3.3 Fair value estimates

The Company adopted the amendment to IFRS 7 for financial instruments that are measured in balance sheet at fair value, which requires the disclosure of fair value measurements by level of the following fair value measurement hierarchy:

. Quoted prices (unadjusted) in active markets for identical assets and liabilities (level 1).

. Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).

. Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing or service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets is the current bid price. These instruments are included in level 1.

The fair value of financial instruments that are not traded in an active market (for example, time deposits and certificates of bank deposit) is determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

. Quoted market prices or dealer quotes for similar instruments.

. Other techniques, such as analysis of discounted cash flows, are used to determine the fair value of the remaining financial instruments.

The only financial instrument measured at fair value are represented by the short-term investment on Certified of Bank Deposits (CDB), classified as cash equivalent, amounting to R$ 2,031,122 and R$ 1,853,177 in December 31, 2011 and 2010, respectively. These investments are measured at fair value through profit and loss at level 2.

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3.4 Financial Instruments

The Company operates with many financial instruments, particularly cash and cash equivalents, including financial investments, and loans and financing as described below.

The estimated fair values of financial instruments are as follows:

	December 31, 2011		December 31, 2010	
	Carrying amount	**Fair value**	**Carrying amount**	**Fair value**
Financial assets				
Cash and cash equivalents	2,149,989	2,149,989	1,989,179	1,989,179
Restricted cash	99,729	99,729	302,570	302,570
Customer accounts receivable,net	1,406,372	1,406,372	1,324,157	1,324,157
Accounts receivable from related party, net	355,621	355,621	368,848	368,848
Escrow deposits	54,178	54,178	43,543	43,543
Financial liabilities				
Loans and financing	8,596,295	8,500,515	8,264,615	9,698,547
Accounts payable to suppliers and Contractors	255,557	255,557	144,043	144,043

Loans and financing

The fair value of the loans and financing as of December 31, 2011 and 2010 are as follow.

	December 31, 2011		December 31, 2010	
	Carrying amount	Market value	Carrying amount	Market value
Bank loans				
Loans and finance local currency (i)	1,866,936	1,756,889	2,721,818	2,866,244
Debêntures (ii)	3,124,159	2,901,483	2,771,562	3,372,377
BNDES (iii)	496,823	496,823	509,572	509,572
Financial lease (vi)	49,609	49,609	-	-
Foreign currency (iv)	3,053,421	3,290,364	2,248,928	2,937,619
Other (v)	5,347	5,347	12,735	12,735
	8,596,295	8,500,515	8,264,615	9,698,547

The fair value was obtained as follow:

(i) Loans and finance – local currency are considered by carrying amount plus contractual interest rate till mature date, discounted to present value considering a future interest rate published by BM&F.

(ii) Debentures are considered by their carrying amount plus contractual interest rate till mature date and discounted to present value considering the future interest rate published by ANBIMA in the secondary market, as of December 31, 2010 and the Company's share traded in the Brazilian market.

(iii) BNDES loans are financial instruments valued at carrying amount plus contractual interest rate till mature date, and are indexed by long term interest rate – TJLP, which is a specific rate and cannot be compared to any other rate available in the market. The Company considers the market value of the financing the same amount recognized in the financial statements as of December 31, 2011.

(iv) Financing in foreign currency are controlled in the original currency, converted using the exchange rate as of the balance sheet date, discounted to present value considering an future exchange rate published by Bloomberg, based on the price of the shares negotiated in the open market.

(v) Other financing in local currency are considered by carrying amount plus contractual interest rate till mature date, discounted to present value considering a future interest rate published by BM&F.

(vi) Financial lease are financial instruments valued at carrying amount plus contractual interest rate till mature date, and are indexed by pre-fixed contractual interest rate, which is a specific rate and cannot be compared to any other rate available in the market. The Company considers the market value of the financing the same amount recognized in the financial statements as of December 31, 2011.

4 Critical accounting estimates and judgments

Estimates and judgments are continually evaluated and are based on historical experience and on other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below:

(a) Allowance for doubtful accounts

The Company records allowance for doubtful accounts in an amount that management considers sufficient to cover probable losses, based on an analysis of customer accounts receivable, in accordance with the accounting policy stated in Note 2.8.

The methodology for determining the allowance for doubtful accounts receivable requires significant estimates, considering a number of factors including historical collection experience, current economic trends, estimates of forecast write-offs, the aging of the accounts receivable portfolio and other factors. While the Company believes that the estimates used are reasonable, actual results could differ from those estimates.

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(b) Intangible assets arising from concession contracts

The Company recognizes intangible assets arising from concession contracts under IFRIC 12. The Company estimates the fair value of construction and other work on the infrastructure to recognize the cost of the intangible asset, which is recognized when the infrastructure is built and provided that it will generate future economic benefits. The great majority of the Company's contracts for service concession arrangements entered with each grantor is under service concession agreements in which the Company has the right to receive, at the end of the contract, a payment equivalent to the unamortized asset balance of the concession intangible asset, which in this case, are amortized over the useful life of the underlying physical assets, thus at the end of the contract, the remaining value of the intangible would be equal to the residual value of the related physical asset.

Concession intangible assets under Concession contracts and Program contracts, in which, at the end of the contract, the Company has no right to receive a payment equivalent to the unamortized asset balance of the concession intangible, are amortized on a straight-line basis over the useful life of the asset or the contract, what incur first. Additional information on the accounting for intangible assets arising from concession contracts is disclosed in Note 2.12(a).

The recognition of fair value for the intangible assets arising on concession contracts is subject to assumptions and estimates, and the use of different assumptions could affect the balances recorded. The estimated useful lives of the underlying assets also requires significant assumptions and estimates, which different assumptions and estimates and changes in future circumstances, could affect the remaining useful lives of the intangible assets and can have a significant impact on the results of operations.

(c) Impairment of long-lived assets

The Company reviews annually long-lived assets for indicators of impairment, primarily intangible assets arising from concession contracts, which include water and sewage system physical assets to be held and used in the business, for the purpose of determining and measuring impairment when events or changes in circumstances indicate that the carrying value of an asset or group of assets may not be recoverable. The assets include the intangible asset of the concession contracts related to water and sewage systems.

In evaluating impairment of long-lived assets, the evaluation requires significant assumptions and estimates regarding matters that are inherently uncertain, including projections of future operating income and cash flows, future growth rates, and the remaining useful lives of the assets and/or the period of the contract, among other factors. In addition, projections are computed over an extended period of time, which subjects those assumptions and estimates to an even larger degree of uncertainty. While the Company believes that the estimates used are reasonable, the use of different assumptions could materially affect the recoverable amount.

(d) Provisions

The Company is party to a number of legal proceedings involving significant claims. These legal proceedings include, among other types, tax, labor, civil, environmental, dispute with customers and suppliers and other proceedings. Additional information of these legal proceedings is disclosed in Note 15. The Company accrues for probable losses resulting from these claims and proceedings when the Company determines that the likelihood that a loss has occurred is probable and the amount of such loss can be reasonably estimated. Therefore, the Company is required to make judgments regarding future events. As a result of the significant judgment required in assessing and estimating these provisions for contingencies, actual losses realized in future periods could differ significantly from actual estimates and could exceed the amounts provisioned.

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Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

(e) Pension benefits

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions, which can differ materially from the real, due to the changes in economic and market conditions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of pension obligations.

The Company determines the appropriate discount rates at the end of each year, which is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. The Company utilizes the interest rate of high quality private papers to determine the appropriate discount rate, which are in the same currency of the payments of the benefits and which has the maturity date close to the respective obligation.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information on the pension plans under Plan G0 and G1 is disclosed in Note 16.

5 Cash and Cash Equivalents

	December 31, 2011	December 31, 2010
Cash and banks	118,867	136,002
Cash equivalents	2,031,122	1,853,177
	2,149,989	1,989,179

Cash and cash equivalents are denominated in *Reais*. Cash equivalents are mainly represented by Bank Deposit Certificates - CDB's, deposited in financial institutions controlled by the São Paulo State Government, which has maturity date less than three months and are ready to be converted in cash and has an insignificant risk to change the total amount.

In December 2011, the average rate of such Cash equivalents was 100.19% of CDI (Interbank Deposit Certificates). In December 2010, the average rate was 99.2% of CDI.

6 Restricted Cash

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In December 31, 2011, the restricted cash totaled R$ 99,729 (R$ 302,570 in 2010) and was recognized in the current asset. Approximately R$8,280 was related to BNDES guarantees and R$ 90,984 referred to proceeds from services provided to entities related to the Municipal Government of São Paulo, net of taxes, which include: day-care centres, schools, management offices, and health centres, whose funds shall be reinvested in the water and sewage system of the city of São Paulo.

7 Customer Accounts Receivable

(a) Balance sheet balances

	December 31, 2011	December 31, 2010
Private sector:		
General and special customers (i) (ii)	885,847	828,261
Agreements (iii)	249,929	250,300
	1,135,776	1,078,561
Government entities:		
Municipal	578,463	556,212
Federal	2,517	2,645
Agreements (iii)	182,381	170,892

	763,361	729,749
Wholesale customers - Municipal governments: (iv)		
Guarulhos	513,218	462,221
Mauá	244,204	220,228
Mogi das Cruzes	14,864	18,818
Santo André	547,764	489,486
São Caetano do Sul	1,955	3,537
Diadema	164,337	149,155
Total wholesale customers	1,486,342	1,343,445
Unbilled revenue	457,321	391,822
Subtotal	3,842,800	3,543,577
Allowance for doubtful accounts	(2,436,428)	(2,219,420)
Total	1,406,372	1,324,157
Current	1,072,659	971,318
Noncurrent (v)	333,713	352,839

(i) General customers - residential and small and mid-sized companies.

(ii) Special customers - large consumers, commercial, industries, condominiums and special billing consumers (industrial waste, wells, etc.).

(iii) Agreements - installment payments of past-due receivables, plus monetary restatement and interest.

(iv) Wholesale customers - municipal governments - This balance refers to the sale of treated water to municipalities, which are responsible for distributing to, billing and charging final customers. Some of these municipalities are questioning in court the tariffs charged by SABESP and do not pay for the amounts in dispute. These amounts are not recognized as operational revenue, due to the uncertainty in the collection.

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The amounts past due, which are substantially included in the allowance for doubtful accounts, are classified in noncurrent assets pursuant to the changes below:

	2011	2010	2009
Balance at beginning of year	1,343,445	1,182,744	1,074,368
Services provided	340,068	353,546	332,975
Receipts - services in the current year	(167,024)	(183,882)	(164,266)
Receipts - services in previous years	(30,147)	(8,963)	(60,333)
Balance at end of year	1,486,342	1,343,445	1,182,744
Current	26,485	38,665	68,898
Noncurrent	1,459,857	1,304,780	1,113,846

(v) The noncurrent portion consists of trade accounts receivable that are past due and renegotiated with customers and amounts past due related to wholesale to municipal governments, and the amounts are net of allowance for doubtful account.

(b) The aging of trade accounts receivable is as follows:

	December 31, 2011	December 31, 2010
Current	1,129,981	1,086,344

Past-due:		
Up to 30 days	184,958	150,358
From 31 to 60 days	79,720	67,539
From 61 to 90 days	50,020	45,153
From 91 to 120 days	39,686	39,084
From 121 to 180 days	70,037	73,300
From 181 to 360 days	137,039	119,967
Over 360 days	2,151,359	1,961,832
Total past-due	2,712,819	2,457,233
Total	3,842,800	3,543,577

(c) Allowance for doubtful accounts

	2011	**2010**
Previous balance	2,219,420	1,854,231
Private sector/government entities	47,679	200,321
Wholesale customers	169,329	164,868
Additions for the year	217,008	365,189
Balance	2,436,428	2,219,420
Current	1,132,638	1,075,939
Noncurrent	1,303,790	1,143,481

The Company accounted for probable losses on accounts receivable in 2011 totaling R$ 120,260 (December 31, 2010 – R$ 232,505), of which R$ 77,905 (net of recoveries) were written off from accounts receivable (in 2010 - R$ 37,505), under Selling expenses.

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The Company does not rely on any specific major customers and no single external customer segment represents 10% or more of its revenues.

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8 Related Party Balances and Transactions

The Company is a party to transactions with its controlling shareholder, the State Government, and companies related to it.

(a) Accounts receivable, interest on shareholders' equity payable and revenue and expenses with the São Paulo State Government

	December 31, 2011	December 31, 2010
Accounts receivable		
Current:		
Water and sewage services (i)	116,441	96,004
GESP Agreement (iii)	41,360	21,360
Allowance for losses (i)	(12,389)	(12,389)
Reimbursement for pension benefits paid - GESP Agreement (ii)	31,887	28,203
Reimbursement for pension benefits paid - Monthly flow (ii)	8,034	4,594
Total current	185,333	137,772
Non-current:		

Water and sewage services - GESP Agreement (iii)	-	52,228
Reimbursement for pension benefits paid - GESP Agreement (ii)	170,288	178,848
Total noncurrent	170,288	231,076
Total receivables from shareholder	355,621	368,848
Provision of water and sewage services	145,412	157,203
Reimbursement of additional retirement and pension benefits	210,209	211,645
Total	355,621	368,848
Interest on shareholders' equity payable to related party	153,368	179,319

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	2011	2010	2009
Gross revenue from sales and services			
Water supply	216,933	204,595	193,771
Sewage services	188,059	178,935	164,532
Payments received from related parties	(425,129)	(401,626)	(349,983)
Financial income	271,847	137,613	73,927

(i) Water and sewage services

The Company provides water supply and sewage collection services to the São Paulo State Government and other companies related to it in accordance, considered by management, as usual market terms and conditions, except for the settlement of receivables which may occur as mentioned in items (iii), (iv) and (v).

(ii) Reimbursement for pension benefits paid

Refers to amounts of supplementary retirement and pension benefits provided for in State Law 4,819/58 ("Benefits") paid by the Company to former employees and pensioners.

Under the Agreement with the São Paulo State Government ("GESP" or the "State"), dated December 11, 2001, GESP recognizes its liability from charges arising from the Benefits, provided that the payment criteria set forth by the State Department of Personnel (DDPE), based on legal guidance of the Legal Consultancy of the Department of Finance and of the State Attorney General's Office (PGE).

As discussed on item (vii), during the assessment of the debt due from GESP to the Company there were certain divergences in the calculation and eligibility criteria of the benefits paid by the Company on behalf of GESP.

For the years ended December 31, 2011, 2010 and 2009, 2,492, 2,554 and 2,597 retired employees, respectively, received additional retirement benefits, and for the years ended December 31, 2011, 2010 and 2009, the Company paid R$ 124,421, R$ 118,408 and R$ 116,082 respectively. There were 14 active employees as of December 31, 2011 who will be entitled to these benefits as a result to their retirement as compared to 32 as of December 31, 2010 and 91 as of December 31, 2009.

In January 2004, the payments of supplement retirement and pension benefits were transferred to the Department of Finance and would be made in accordance with the calculation criteria determined by the PGE. As a result of a court decision, the responsibility for making the payments returned to SABESP, as originally established.

(iii) GESP Agreement

On December 11, 2001, the Company, the São Paulo State Government (through the State Department of Finance Affairs, currently Department of Finance) and the Water and Electricity Department (DAEE), with the intermediation of the State Department of Sanitation and Energy (former Department of Water Resources, Sanitation and Construction Works), entered into the Obligations, Payment Commitment and Other Covenants Acknowledgement and Consolidation Agreement ("GESP Agreement") for the settlement of outstanding debts between GESP and the Company related to the provision of water supply and sewage services and to the Benefits.

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In view of the strategic importance of the Taiaçupeba, Jundiaí, Biritiba, Paraitinga and Ponte Nova reservoirs for ensuring and maintaining the Upper Tietê water volume, the Company agreed to receive them as partial repayment of the reimbursement related to the Benefits. The DAEE would transfer the reservoirs to the Company, replacing the amount owed by GESP. However, the São Paulo State Public Prosecution Office challenged the legal validity of this agreement, and its main argument is the absence of a specific legislative authorization for disposal of DAEE's assets. The Company's legal advisors assess the risk of loss in this lawsuit as probable, in case the legislative authorization is not obtained, which would hinder the transfer of the related reservoirs as a partial settlement of the balance receivable.

(iv) First Amendment to the GESP Agreement

On March 22, 2004, the Company and the São Paulo State Government amended the terms of the original GESP Agreement, (1) consolidating and recognizing the amounts due by the São Paulo State Government for water supply and sewage collection services provided, monetarily adjusted through February 2004; (2) formally authorizing the offset of amounts due by the São Paulo State Government with interest on shareholders' equity declared by the Company and any other debt owed to the São Paulo State Government as of December 31, 2003, monetarily adjusted through February 2004; and (3) defining the payment conditions of the remaining liabilities of the São Paulo State Government for the receipt of the water supply and sewage services.

(v) Second Amendment to the GESP Agreement

On December 28, 2007, the Company and the São Paulo State Government, represented by the Department of Finance, signed the second amendment to the terms of the original GESP Agreement, agreeing upon the payment in installments of the remaining balance of the First Amendment, amounting to R$ 133,709 at November 30, 2007, to be

paid in 60 monthly and consecutive installments of the same amount, beginning on January 2, 2008. The amount of the installments will be monetarily restated according to the fluctuation of the IPCA-IBGE, plus interest of 0.5% per month.

The State and SABESP agreed on immediately resuming their compliance with their mutual obligations under new assumptions: (a) implementation of an electronic bill management system to facilitate and speed up the monitoring of payment processes and budget management procedures; (b) structuring of the Rational Water Use Program (PURA) to rationalize the consumption of water and the amount of the water and sewage bills under the responsibility of the State; (c) establishment, by the State, of criteria for budgeting so as to avoid the reallocation of amounts to a specific water and sewage accounts as from 2008; (d) possibility of registering state bodies and entities in a delinquency system or reference file; (e) possibility of interrupting water supply to state bodies and entities in the case of nonpayment of water and sewage bills.

(vi) Third Amendment to the GESP Agreement

On November 17, 2008, GESP, SABESP and DAEE signed the third amendment to the GESP Agreement, through which GESP recognized a debt balance payable to SABESP totaling R$ 915,251, monetarily adjusted up to September 2008 in accordance with the fluctuation of the IPCA-IBGE, corresponding to the Undisputed Reimbursement (see item (iii) above), determined by FIPECAFI. SABESP accepted on a provisional basis the reservoirs as part of the payment of the Undisputed Reimbursement and offered to GESP a provisional settlement, recognizing a credit totaling R$ 696,283, corresponding to the value of the reservoirs in the Upper Tietê system. The Company did not recognize the reimbursement receivable of R$696,283 related to the reservoirs, as it is not virtually certain that will be transferred by the State. The final settlement will only be effected with the actual transfer of the property with the proper Registry of Deeds Office. The remaining balance totaling R$ 218,967 is being paid in 114 monthly, consecutive installments, totaling R$ 1,920 each, including the annual IPCA/FIPE fluctuation, plus interest of 0.5% p.m., the first of which fell due on November 25, 2008.

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The Company and the São Paulo State Government are working together to obtain legislative authorization to transfer the reservoirs to SABESP, overcoming the uncertainties arising from the public lawsuit challenging the absence of a specific legislative authorization for the transfer of the property of the reservoirs.

In addition, the third amendment provides for the regularization of the monthly flow of benefits. While SABESP is liable for the flow of monthly payment of benefits, the State shall reimburse SABESP based on the criteria identical to those applied when determining the Undisputed Reimbursement. Should there be no preventive court decision, the State will assume the flow of monthly payment of benefits portion deemed as undisputed.

(vii) Controversial Amount of Benefits

As mentioned before, on November 17, 2008 the Company and the State signed the third amendment to the GESP Agreement, when the reimbursements called disputed and undisputed were quantified. The amendment established the efforts to calculate the so-called Disputed Reimbursement of the Benefits. Under the fourth clause of the amendment, the Disputed Reimbursement represents the difference between the Undisputable Reimbursement and the amount actually paid by the Company as pension benefits and pensioners set out in Law 4,819/58, for which, the Company understands, the State of São Paulo is originally liable, but paid by SABESP by May 2008, under a court order.

By entering into the third amendment, the State's Legal Representative (PGE) agreed to reassess the differences that gave rise to the disposed reimbursement of benefits set out in Law 4,819/58. At the time, the expectation was based on the willingness of the PGE to reanalyze the issue and the implied right of the Company to the reimbursement, including based on opinions from outside legal advisors.

However, new opinions issued by the PGE and received on September 4 and 22, 2009 and January 4, 2010, refute the reimbursement of the largest portion of the controversial amount.

Even though the negotiations with the State are still in progress, it is not possible to assure that the Company will recover the receivables related to the Disputed Reimbursement without dispute.

As part of the actions intended to recover the receivables that management considers due by the State, related to discrepancies in the reimbursement of the pension benefits paid by the Company, the Company: (i) on March 24, 2010, reported to the controlling shareholder the official letter approved by the executive committee, proposing that the matter be discussed at the São Paulo Stock Exchange (BM&FBovespa) Arbitration Chamber; (ii) in June 2010, presented to Department of Finance a proposal to solve the outstanding items, such proposal was not accepted; (iii) on November 9, 2010, filed a judicial action against the State of São Paulo pleading the entire reimbursement related to employee benefits set out in Law 4,819/58 to finalize the discussion between the Company and GESP. The Company will persist to obtain an agreement with GESP since the management believes that it is the better to the Company and to its shareholders than wait until the end of the judicial action.

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The Company's management decided to not recognize the reimbursements which were not considered virtually certain that will be reimbursed by the State. As of December 31, 2011 and 2010, the amounts not recorded by the Company, related to the pension benefits paid on behalf of the State by the Company, totaled R$ 1,290,663 and R$ 1,230,064, respectively, including the amount of R$ 696,283 related to the transfer of the reservoirs in the Upper Tietê system. As a result, the Company also recognized the obligation related to the pension benefit obligations maintained with the beneficiaries and pensioners of Plan G0, whose right it is to be paid by SABESP and is not considered virtually certain that SABESP will be reimbursed by the State. As of December 31, 2011 and 2010, the pension benefit obligations of Plan G0 totaled R$ 1,512,078 and R$ 1,316,706, respectively. For detailed information on the pension benefit obligations refer to Note 16.

(b) Agreements for the use of reservoirs

In its operations, the Company uses the Guarapiranga and Billings reservoirs, which are owned by another entity controlled by the São Paulo State Government; should these reservoirs not be available for use to the Company, there could be the need to collect water in more distant places. The Company does not pay any fee for the use of these reservoirs but it is responsible for their maintenance and operating costs.

(c) Agreements with reduced tariffs with State and Municipal Government Entities that joined the Rational Water Use Program (PURA).

The Company has signed agreements with government entities related to the State Government and municipalities where it operates that benefit from a reduction of 25% in the tariff of water supply and sewage services when they are not in default. These agreements provide for the implementation of the rational water use program, which takes into consideration the reduction in the consumption of water.

(d) Guarantees

The State Government provides guarantees for some loans and financing of the Company and does not charge any fee with respect to such guarantees.

(e) Personnel assignment agreement among entities related to the State Government

The Company has personnel assignment agreements with entities related to the State Government, under which the expenses are fully passed on and monetarily reimbursed. In 2011, the expenses related to personnel assigned by SABESP to other state government entities amounted to R$ 10,888 (2010 - R$ 5,640 and 2009 - R$ 5,359).

In 2011 there was no personnel assigned by other entities to SABESP. In 2010, the expenses related to personnel assigned by other entities to SABESP totaled R$264 and in 2009 totaled R$ 335.

(f) Services obtained from entities related to the State Government

As of December 31, 2011 and 2010, SABESP had an outstanding amount payable of R$ 12,062 and R$ 11,395, respectively, for services rendered by São Paulo State Government entities, including the supply of electric power by Companhia Energética de São Paulo – CESP, which represents 86% in 2011.

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(g) Nonoperating assets

As of December 31, 2011 the Company had an amount of R$ 21,531 (December 31, 2010 - R$ 25,371) mainly related to free land lend to the associations, support entities, non-governmental organizations and to DAEE (Water and Electricity Department), among others. The free land lend to DAEE amounts to R$ 2,289.

(h) Banco do Brasil

The State of Sao Paulo sold exclusive rights in the provision of banking services administration entities directly and indirectly in favor of Banco Nossa Caixa, on March 27, 2007, and in favor of Banco do Brasil, May 27, 2010. Through the lawsuit in question, SABESP pleads financial compensation for the sale of its exclusive rights, requiring a percentage of the values that the State of São Paulo received from each of the financial institutions.

On June 28, 2011 it was executed the Term of Settlement between the Company and the State of Sao Paulo, whereby the Company received the amount of R$ 63,366 upon reduction, as compensation of credit held by the State, corresponding to interests on shareholders' equity in fiscal 2010.

(i) SABESPREV

The Company sponsors a private defined benefit pension plan, which is operated and administered by Fundação SABESP de Seguridade Social - SABESPREV. The net actuarial liability recognized as of December 31, 2011 amounted to R$ 538,619 (December 31, 2010 - R$ 487,332).

(j) Key management compensation

Management Fees:

SABESP's compensation policy for directors and officers is set out according to guidelines of the São Paulo State Government, the CODEC (State Capital protection Board), and are based on performance, market competitiveness, or other indicators related to the Company's business, and is subject to approval by shareholders at an Annual Shareholders' Meeting.

Officers' compensation is limited to the compensation of the State Governor, and the Board of Directors' compensation is equivalent to 30 percent of the executive committee' overall compensation, contingent on attendance of at least one monthly meeting.

The objective of the compensation policy is to set a private sector management paradigm to retain its staff and recruit competent, experienced and motivated professionals, considering the level of management efficiency currently required by the Company.

In addition to monthly fee, the members of the Board of Directors and the Executive Committee receive:

Bonuses:

For the purposes of compensating directors and officers of the companies where the State is the controlling shareholder, as an incentive policy, providing the company records quarterly, half-yearly, and yearly profits, and distributes mandatory dividends to shareholders, even if in the form of interest on shareholders' equity. Annual bonuses cannot exceed the lower of six times the monthly compensation of the officers/directors nor 10 percent of the interest on shareholders' equity paid by the company.

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Annual award:

Equivalent to a monthly fee, calculated on a prorated basis in December of each year.

The purpose of this award is to correspond to the thirteenth salary paid to Company employees, as officers and directors' relationship with the Company is governed by its bylaws and not the labor code.

Benefits: paid only to officers - meal ticket, basket of food staples, medical care, weekly paid rest typified as a paid leave of 30 calendar days, and payment of a premium equivalent to one third of the monthly fee.

The compensation related to the members of its board of directors and officers amounted to R$ 2,614, R$ 2,601 and R$ 2,606 for the years ended December 31, 2011, 2010, and 2009, respectively, and it refers to salaries and other short-term benefits to employees and management. An additional amount of R$ 1,069, related to the bonus program, also a short term benefit, was accrued as of December 31, 2011 (December 31, 2010 - R$ 845; December 31, 2009 – R$ 856).

9 Indemnities Receivable

Indemnities receivable are a noncurrent asset that represents amounts receivable from the Municipality of Diadema as an indemnity for their unilateral termination of the concession for water supply and sewage services of the Company in 1995. As of December 31, 2011, this balance totaled R$ 60,295. As of December 31, 2010, the indemnities receivable was R$146,213 related to the municipalities of Diadema R$ 60,295 and Mauá R$85,918.

The Company invested in the construction of water and sewage systems in the municipalities of Diadema and Mauá in order to meet the concession service commitments. For the unilateral termination of the Diadema and Mauá concessions, the municipalities assumed the responsibility of supplying water and sewage services in those regions. At that time, the Company reclassified the balances of property, plant and equipment related to the assets used in those municipalities to noncurrent assets (indemnities receivable).

As of December 31, 2011, the net book value of property, plant, and equipment relating to the municipality of Diadema, reclassified in December 1996, amounted to R$ 75,231 and the indemnity balance from the municipality amounted to R$ 60,295, on December 31, 2011.

SABESP filed lawsuits to collect the amounts due by the municipalities. With respect to Diadema, the decision of the lower court judge was unfavorable to SABESP. The Company filed an appeal and in December 2005, SABESP's appeal to have the agreement entered into with the municipality of Diadema declared valid was partially accepted. In December 2007, the decision that accepted the execution of the Companhia de Saneamento the Diadema - Saned was rendered, ordering this company to be summoned to pay the full amount of the debt within 15 days under the penalty of fine. The judge approved the seizure of cash from Saned's bank accounts and short-term investments (online seizure) of up to 10% of the adjusted debt. An appeal was filed against this decision, but the Appellate Court upheld the final and unappealable decision. R$ 2,919 were seized and withdrawn on March 3, 2009. Subsequently, the Court of Justice issued an injunction determining the seizure through weekly deposits by Saned in the amount corresponding to 20% of everything received in its bank accounts and short-term investments.

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In October 2009, a judicial decision recognized the debt and the execution against the municipality which will pay using precatory. In September 2011, the Company received a favorable decision from the Court of Justice, considering constitutional the municipal law which permitted the retention of the ICMS.

On December 29, 2008, Saned and the Municipality of Diadema entered into a Letter of Intent with the São Paulo State and SABESP for the purpose of preparing studies and conducting negotiations to guide Diadema's and SABESP's decisions, aiming to establish SABESP as the exclusive provider of water supply and sewage services for the City of Diadema.

The parties agree that the settlement of the existing conflicts between the companies is indispensable for the proper development of the public utility services of water supply and sewage services in the municipality of Diadema.

In January 2009, the parties filed a joint petition requesting the suspension of new seizures, for a three-month period, trying to enable an agreement. The suspension was confirmed by the Tax Court. As the settlement on which a possible agreement will be based was maintained, the suspension request was last renewed in November 2011.

As of December 31, 2011, the net book value of property, plant, and equipment relating to the municipality of Mauá, reclassified in December 1999, totaled R$ 103,763 and the indemnities receivables the municipality totaled R$ 85,918. The decisions are being favorable to the Company and the collection will be made by precatory, which will be recognized in the financial statements when realized, due to the uncertainties in the collection. Due to this fact, in December 2011, the Company recognized a provision for losses in the total amount and the judicial demand is still

in progress.

With respect to Mauá, a lower court decision demanded this Municipality pay the amount of R$ 153.2 million to SABESP as a compensation for the investments made by SABESP in the city and for the loss of profits. In August 2008, the Court of Justice decided for the integral maintenance of the lower court decision. The Municipality of Mauá filed special and extraordinary appeals against the decision. Both appeals were denied by the Court of Justice, which led to the filing of a bill of review with the Superior Court of Justice and Federal Supreme Court. The Federal Supreme Court partially accepted the appeal to reduce the fees.

Based on legal opinion, management believes that the Company has legal rights to receive the indemnities and is monitoring the judicial lawsuit.

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10 Intangible Assets

	December 31, 2011			December 31, 2010		
	Cost	Accumulated amortization	Net	Cost	Accumulated amortization	Net
Intangible rights arising from concession contracts Service concession						
Agreements (i)	14,404,168	(2,848,829)	11,555,339	13,980,141	(3,242,270)	10,737,871
Concession contracts (ii)	762,987	(223,693)	539,294	706,423	(189,145)	517,278
Program contracts (iii)	1,120,104	(49,324)	1,070,780	900,686	(36,302)	864,384
Program contracts – commitments (iv)	473,327	(38,341)	434,986	333,942	(22,666)	311,276
Service contract – São Paulo (v)	7,039,763	(517,288)	6,522,475	6,196,699	(99,837)	6,096,862
New businesses (vi)	21,400	(4,923)	16,477	12,129	(901)	11,228
	23,821,749	(3,682,398)	20,139,351	22,130,020	(3,591,121)	18,538,899
Software licenses	52,755	(50,429)	2,326	49,458	(41,521)	7,937
Total	23,874,504	(3,732,827)	20,141,677	22,179,478	(3,632,642)	18,546,836

Movements on the intangible assets are as follows:

	December 31, 2008	Additions	Write-off and disposals	Amortization	De
Intangible rights arising on concession contracts					
Service concession agreements (i)	14,071,507	1,849,993	(51,778)	(497,607)	
Concession contracts (ii)	509,724	17,429	-	(23,008)	
Program contracts (iii)	622,383	162,466	-	(12,060)	
Program contracts – commitments (iv)	249,639	18,424	-	(9,260)	
	15,453,253	2,048,312	(51,778)	(541,935)	
Software licenses (vi)	9,602	12,954	-	(12,991)	
	15,462,855	2,061,266	(51,778)	(554,926)	

	December 31, 2009	Additions	Reclassification	Write-off and disposals	Amorti
Intangible rights on concession contracts					
Service concession agreements (i)	15,372,115	1,767,747	(6,019,568)	(15,857)	(36
Concession contracts (ii)	504,145	37,122	-	-	(2
Program contracts (iii)	772,789	106,125	-	-	(1
Program contracts – commitments (iv)	258,803	62,748	-	-	(1
Service contract – São Paulo (v)	-	177,131	6,019,568	-	(9
New businesses (vi)	-	12,129	-	-	
	16,907,852	2,163,002	-	(15,857)	(51
Software licenses	9,565	6,779	-	-	(
	16,917,417	2,169,781	-	(15,857)	(52

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	December 31, 2010	Additions	Reclassification	Write-off and disposals	Amorti
Intangible rights on concession contracts					
Service concession agreements (i)	10,737,871	1,125,335	(63,487)	(16,228)	(22
Concession contracts (ii)	517,278	2,167	57,718	(2,780)	(3
Program contracts (iii)	864,384	225,510	(31)	(3,810)	(1
Program contracts – commitments (iv)	311,276	139,385	-	-	(1
Service contract – São Paulo (v)	6,096,862	930,959	(36,234)	(32,383)	(43
New businesses (vi)	11,228	9,271	-	-	(
	18,538,899	2,432,627	(42,034)	(55,201)	(73
Software licenses	7,937	3,297	-	-	(
	18,546,836	2,435,924	(42,034)	(55,201)	(74

The reclassification amounting to R$ 42,034 is related to the accounts “investment property”.

The status of our aggregated construction in progress of the underlying assets of concession contracts at the end of the year is as follows:

	As of December 31, 2009		
	Water	**Sewage**	**Total**
Construction costs incurred	760,707	1,248,957	2,009,664
Recognized construction revenue	772,118	1,267,691	2,039,809

	As of December 31, 2010		
	Water	**Sewage**	**Total**
Construction costs incurred	1,028,115	1,052,966	2,081,081
Recognized construction revenue	1,051,419	1,079,265	2,130,684

	As of December 31, 2011		
	Water	**Sewage**	**Total**
Construction costs incurred	1,044,122	1,142,198	2,186,320
Recognized construction revenue	1,066,524	1,168,254	2,234,778

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There are no contingent assets or liabilities related to the construction contracts outstanding.

Investments committed

The estimated amount related to investments is R$ 2,274 million to be spent from 2012 to 2015 (unaudited).

Intangible rights arising from concession contracts

The Company operates concession contracts as defined by IFRIC 12 covering the provision of basic and environmental sanitation services, water supply and sewage services. These concession arrangements set out rights and obligations relative to the infrastructure and to the public service (See Note 2.12(a)). A general obligation also exists to return the concession infrastructure to the grantor in good working condition at the end of the concession.

As of December 31, 2011 and 2010, the Company operates in 363 municipalities in the State of São Paulo. In most of these municipalities operations are based on 30-year concession period. The agreement with the municipality of São Paulo is accounted for as a service concession arrangement.

The services provided by the Company are billed at a price established by the "*Agência Reguladora de Saneamento e Energia do Estado de São Paulo*" ("ARSESP").Intangible rights arising on concession contracts are comprised of:

(i) Service concession agreements

The concession contracts state that the property will revert to the grantor at the end of the period, through compensation for the residual value or market value of the underlying physical assets in accordance with the stipulations in each contract and amortization are calculated using the straight-line method, which consider the physical assets economic useful lives.

(ii) Concession contracts

From 1999 through 2006, the negotiations for new concessions were conducted on the basis of the economic and financial profit or loss of the transaction, determined in a valuation report issued by independent appraisers.

The amount determined in the related contract, after the transaction is closed with the municipal authorities, realized through the subscription of the Company's shares or in cash, is recorded as "concession contract" and amortized over the period of the related concession (usually 30 years). As of December 31, 2011, 2010 and 2009 there were no amounts pending related to these payments to the municipalities.

Intangible assets are amortized on a straight line basis over the term of the concession agreements or for the useful lives of the underlying assets, which was lower, entered into with the related municipality.

(iii) Program contracts

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It refers to the renew of contracts formerly denominated full concession to operation concession, by program contracts which purpose is the water supply, sewage and sanitation public service. The assets acquired or constructed are being amortized during the contract period (30 years) or for the useful lives of the underlying assets, which was lower.

(iv) Program contracts - Commitments

After the enactment of the regulatory framework law 11,445 in 2007, renewals of concession agreements are made through "program contracts". In some program contracts the Company committed to financially participate in social and environmental sanitation actions. These assets built and commitments assumed are being amortized on a straight line basis according to the effective period of the program contract (mostly 30 years).

As of December 31, 2011, the amounts not yet disbursed related to commitments under the program contracts are recorded in “Other obligations” in current liabilities in the amount of (R$ 62,287 and R$ 83,084), and noncurrent liabilities in the amount of (R$ 130,978 and R$ 66,856), as of December 31, 2011 and 2010, respectively.

(v) Service contract – São Paulo

On November 14, 2007, the Company and the Municipality of São Paulo (the Parties) entered into an Agreement to establish the conditions that ensure the stability in the provision of water supply and sewage services, and environmental utility services in the city of São Paulo, the main provisions of which are as follows:

(a) the Parties made the commitment to take basic sanitation and environmental actions, complementary to the actions of the Municipality of São Paulo, by investing in the deployment and continuity of programs such as: Programa Córrego Limpo (Clean River Program) and Programa de Uso Racional da Água - PURA (Rational Water Use Program), the purpose of which is to ensure a decrease in water consumption by City government units, ensuring water supply to and the quality of living of the population;

(b) starting November 14, 2007, all the amounts paid by the Municipality of São Paulo to SABESP, referring to consumption by City departments, agencies, and foundations, net of taxes, will be used in basic sanitation and environmental actions in the municipality; and

(c) the Municipality is committed to restart the payment of consumption bills issued by SABESP, starting from November 14, 2007.

The payments referred on item (b) are not being recognized in a specific account related to basic sanitation services and environmental services. The remaining amount received and not yet distributed, on December 31, 2011 was R$ 86,956 (R$80,379 on December 31, 2010).

On June 23, 2010, the Company entered into an agreement with the State of São Paulo and the Municipality of São Paulo, approved by the Regulatory agency of Sanitation and Energy of the State of São Paulo - ARSESP, to regulate the provision of water and sewage services in the city of São Paulo for a 30 year period, which is extendable for an another 30 year period. The main terms of the agreement are as follow:

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1. The State and the Municipality of São Paulo grant to SABESP the right to explore the sanitation service in the capital of the State of São Paulo, which consists of the obligation to such provide service and charge the respective tariff for this service;

2. The State and the Municipality sets forth ARSESP as the agency responsible for regulating the tariff, controlling and monitoring the services;

3. The evaluation model of the contract was the discounted cash flow which considered the financial and economic sustainability of the operation;

4. All operational costs, taxes, investments and the opportunity cost of the investees and the creditors of SABESP were considered in the cash flow analysis;

5. The estimated investments mentioned in the agreement comply with 13% of the gross revenue from the municipality of São Paulo, net of the taxes on revenues. The investment plan, considering the execution of SABESP, must be compatible to the activities and programs included in the sanitation plan of the State, Municipality, and if necessary, in the plan of the Metropolitan region. The invest plan is not irrevocable and will be reviewed by management committee each four years, specially the investments to be executed in the subsequent period;

6. The payment related to the Municipal Fund of Environmental Sanitation and Infrastructure to be applied in the sanitation service within the municipality must be recovered through the tariffs charges. Such payment represents 7.5% of the total revenue from the municipality of São Paulo, net of the taxes on revenue;

7. The opportunity cost of the investees and the creditors was established by the Weighted Average Cost of Capital (WACC) methodology. The WACC was the interest rate used to discount the cash flow of the operation;

8. The agreement considers the recovery of the assets in operation, evaluated by external specialists or by historical costs plus monetary indexation, to be defined by ARSESP. There should be no residual amount of the assets at the end of the contract.

The agreement represents approximately 55.1% of the total revenue of the Company.

The Company and the municipality of São Paulo did not achieve an agreement to solve the financial pending accounts in place in the date of the contract signature, related to the water and sewage services provided to the property of the municipality. Due to this fact, the Company filed a lawsuit to collect the amounts due by the municipality.

(vi) New businesses

In August 2009, the Company and Companhia de Saneamento de Alagoas – CASAL signed 60 month-period agreement to provide specialized technical services to implement a program to reduce the losses and retain revenues in the municipality of Maceio. The construction started in 2010.

As of December 31, 2011, the total amount recognized in “New businesses” caption amount to R$ 16,477 (R$ 11,228 in 2010), and the amount of CASAL amount to R$ 15,664 (December 31, 2010 R$11,228).

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(a) Disposals of concession intangible assets

In 2011, 2010 and 2009, the Company wrote off concession intangible assets items totaling R$ 55,202, R$ 15,857 and R$ 51,778, respectively, due to obsolescence, theft, misplacements, unproductive wells and projects considered economically unfeasible.

(b) Capitalization of interest and others financial charges

In 2011, 2010 and 2009, the Company capitalized interest and inflation adjustment, including related foreign currency exchange effects, in concession intangible assets during the construction period of the qualifying assets totaling R$ 261,886, R$ 228,899, and R$ 51,625, respectively.

(c) Revenue from construction

The Company is responsible to construct and install the infrastructure related to the concession contract, using its own resources or contracting third parties to perform the work, being exposed to its risks and benefits.

The Company recognizes revenue from construction related to construction costs added by gross margin. In general, the constructions regarding the concessions are performed by third parties. In this case the margin is lower and it is to cover the costs of management and supervision of the construction. Based on the studies and the benchmark with

companies in the construction market the margin used in 2011 was 2.3% (2010 was 2.6%).

The construction margin in 2011, 2010 and 2009 was R$ 48,458, R$ 49,603, and R$ 30,145, respectively.

(d) Expropriations

As a result of the construction of priority projects related to water and sewage systems, the Company was required to expropriate or establish rights of way in third-parties' properties, and the owners of these properties will be compensated either amicably or through courts.

The assets received as a result of expropriations are recorded as concession intangible assets after the transaction is completed. In 2011, 2010 and 2009, the total amount related to expropriations was R$ 12,167, R$ 10,779 and R$ 6,244, respectively.

(e) Assets pledged as guarantee

As of December 31, 2011 and 2010, the Company had underlying physical assets totaling R$ 249,034 offered as guarantee to the request for the PAES (tax debt refinancing program) (Note 13).

(f) Public-Private-Partnership (PPP)

The Company and CAB-Sistema Produtor Alto Tiete S.A., special purpose entity, formed by Galvão Engenharia S.A. and Companhia Águas do Brasil – Cab Ambiental, signed in June 2008 the contract of public-private-partnership of Alto Tiete production system.

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The contract last 15 years which purpose is expand the capacity of treated water of Taiaçupeba from 10 thousand to 15 thousand of liters per second. The operation initiated in October 2011.

As of December 31, 2011 and 2010 the amount recognized as intangible asset related to PPP was R$ 474,818 and R$ 353,468, respectively.

(g) Impairment

As of December 31, 2011 and 2010, no provision for impairment was recognized.

(h) Construction in progress

As of December 31, 2011, the construction in progress recognized in the intangible assets amounts to R$ 5.7 billion (R$ 5.3 billion in 2010).

11 Property, Plant and Equipment

	December 31, 2011			December 31, 2010		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
Land	109,303	-	109,303	119,567	-	119,567
Buildings	39,574	(30,142)	9,432	41,014	(28,983)	12,031
Equipment	160,915	(100,626)	60,289	162,270	(90,804)	71,466
Transportation equipment	21,071	(19,549)	1,522	20,025	(18,364)	1,661
Furniture, fixtures and equipment	27,810	(27,601)	209	26,831	(26,378)	453
Construction in progress	174,668	-	174,668	43,222	-	43,222
Other	2,758	(1,713)	1,045	2,590	(1,384)	1,206
	536,099	(179,631)	356,468	415,519	(165,913)	249,606

Movements on the property, plant and equipment are as follows:

	December 31, 2008	Additions	Write-off and Disposals	Depreciation	December 31, 2009
Land	106,227	14,193	(535)	-	119,885
Buildings	16,744	172	(20)	(1,341)	15,555
Equipment	47,760	4,870	(29)	(7,051)	45,550
Transportation equipment	1,172	1,262	-	(930)	1,504
Furniture, fixtures and equipment	6,334	6,756	(167)	(6,569)	6,354
Other	1,173	564	(4)	(151)	1,582
	179,410	27,817	(755)	(16,042)	190,430

	December 31, 2009	Additions	Write-off and Disposals	Depreciation	December 31, 2010
Land	119,885	-	(318)	-	119,567
Buildings	15,555	-	(210)	(3,314)	12,031
Equipment	45,550	41,251	-	(15,335)	71,466
Transportation equipment	1,504	1,831	-	(1,674)	1,661
Furniture, fixtures and equipment	6,354	1,079	-	(6,980)	453
Construction in progress	-	43,222	-	-	43,222
Other	1,582	-	-	(376)	1,206
	190,430	87,383	(528)	(27,679)	249,606

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	December 31, 2010	Additions	Reclassification	Write-off and Disposals	Depreciation	December 31, 2011
Land	119,567	-	(10,264)	-	-	109,303
Buildings	12,031	-	(287)	(3)	(2,309)	9,432
Equipment	71,466	9,940	-	(1,333)	(19,784)	60,289
Transportation equipment	1,661	1,050	-	(4)	(1,185)	1,522
Furniture, fixtures and equipment	453	1,081	-	(7)	(1,318)	209
Construction in progress	43,222	131,446	-	-	-	174,668
Other	1,206	174	-	-	(335)	1,045
	249,606	143,691	(10,551)	(1,347)	(24,931)	356,468

The reclassification amounting to R$ 10,551 is related to the account “investment property”.

(a) Depreciation

The Company revises the estimated useful lives of its property, plant and equipment annually. In 2009, the Company adjusted the estimated useful lives of its property, plant and equipment, which were accounted for prospectively from January 1, 2009. The annual depreciation rates were as follows:

Property, plant and equipment	**2011**	**2010**	**2009**

Buildings	2%	2%	2%
Equipment	5%	5%	5%
Transportation equipment	10%	10%	10%
Furniture, fixtures and equipment	6.7%	6.7%	6.7%

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12 Loans and Financing

	December 31, 2011			December 31, 2010		
	Current	**Noncurrent**	**Total**	**Current**	**Noncurrent**	**Total**
Denominated in local currency						
Federal Government/Banco do Brasil	348,695	479,548	828,243	316,541	818,359	1,134,900
8th issue debentures	-	-	-	465,086	-	465,086
9th issue debentures	-	-	-	33,333	198,242	231,575
10th issue debentures	2,008	283,293	285,301	-	279,497	279,497
11th issue debentures	202,500	1,005,748	1,208,248	-	1,205,451	1,205,451
12th issue debentures	-	499,613	499,613	-	499,715	499,715
13th issue debentures	599,411	-	599,411	-	-	-
14th issue debentures	-	279,810	279,810	-	-	-
1st issue debentures – Aquapolo	-	160,099	160,099	-	-	-
Caixa Econômica Federal	110,646	917,574	1,028,220	91,031	783,426	874,457
Promissory notes	-	-	-	-	599,755	599,755
FIDC - SABESP I	-	-	-	13,889	-	13,889
National Bank for Economic and Social Development (BNDES)	37,554	3,491	41,045	43,403	40,518	83,921
National Bank for Economic and Social Development (BNDES) Baixada Santista	16,309	114,165	130,474	-	130,474	130,474
National Bank for Economic and Social Development (BNDES) PAC	6,428	67,489	73,917	1,649	44,352	46,001
National Bank for Economic and Social Development (BNDES) Onda Limpa	14,270	235,383	249,653	-	246,986	246,986
Foz do Brasil – Mutual	-	-	-	-	52,896	52,896
Santander	-	-	-	2,427	-	2,427
Financial leasing	-	49,609	49,609	-	-	-
Other	1,784	3,503	5,287	2,816	3,850	6,666
Interest and others charges	101,028	2,916	103,944	141,991	-	141,991

Total denominated in local currency	1,440,633	4,102,241	5,542,874	1,112,166	4,903,521	6,015,687
Denominated in foreign currency						
Inter-American Development Bank (IADB) US$386,862,000 (2010 - US$ 344,898,000)	71,591	652,141	723,732	63,185	511,484	574,669
International Bank for Reconstruction and Development (IBRD) US$10,316,000	-	18,928	18,928	-	-	-
Eurobonds - US$ 140,000,000 (2010 - US$ 140,000,000)	-	262,067	262,067	-	232,612	232,612
Eurobonds - US$ 350,000,000 (2010 – US$ 350,000,000)	-	649,024	649,024	-	576,107	576,107
JICA - ¥ 39,456,912,000 (2010 - ¥ 21,316,000,000)	53,204	905,529	958,733	11,810	425,168	436,978
IADB 1983AB - US$ 226,058,000 (2010 - US$ 250,000,000)	44,911	376,355	421,266	39,893	373,575	413,468
Interest and others charges	19,671	-	19,671	15,089	5	15,094
Total denominated in foreign currency	189,377	2,864,044	3,053,421	129,977	2,118,951	2,248,928
Total loans and financing	1,630,010	6,966,285	8,596,295	1,242,143	7,022,472	8,264,615

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Financial institution	Currency	Guarantees	Maturity	Annual interest rates	Foreign exchange adjustment
Local currency					
Federal Government/Banco do Brasil	Real	São Paulo State Government and Own funds	2014	UPR + 8.50%	
10th issue debentures	Real	Own funds	2020	TJLP + 1.92% (1st & 3rd series) & IPCA + 9.53%	
11th issue debentures	Real	Own funds	2015	(2nd series) DI + 1.95% & DI + 1.4%	
12th issue debentures	Real	Own funds	2025	(2nd series) TR + 9.5%	
13th issue debentures	Real	Own funds	2012	CDI + 0.65%	
14th issue debentures	Real	Own funds	2022	TJLP + 1.92% and 9.19%	
1st issue debentures - Aquapolo	Real	Own funds	2029	TR + 8.75%	
Caixa Econômica Federal	Real	Own funds	2011/2032	UPR + 5% to 9.5%	
National Bank for Economic and Social Development (BNDES)	Real	Own funds	2013	3% + TJLP 6% LIMIT	
National Bank for Economic and Social Development (BNDES) Coastal region	Real	Own funds	2019	2.5% + TJLP 6% LIMIT	
National Bank for Economic and Social Development (BNDES) PAC	Real	Own funds	2023	2.15% + TJLP 6% LIMIT	
National Bank for Economic and Social Development (BNDES) ONDA LIMPA	Real	Own funds	2025	1.92% + TJLP 6% LIMIT	

Foz do Brasil - Mutual	Real	-	2012	CDI + 1.75% + IOF	
Santander	Real	-	2011	CDI	
Other	Real	-	2011/2018	12%/CDI/TJLP + 6%	

Foreign currency

Inter-American Development Bank (IADB) US$ 344,898,000 (2009 - US$ 374,647,000)	U.S. dollar	Federal Government	2016/2035	1.14% to 3.29%	Currency Basket Fluctuation + US$
International Bank for Reconstruction and Development - BIRD	U.S. dollar	Federal Government	2034	0.43%	US$
Eurobonds - US$ 140,000,000 (2010 - US$ 140,000,000)	U.S. dollar	-	2016	7.50%	US$
Eurobonds - US$ 350,000,000	U.S. dollar	-	2020	6.30%	US$
JICA - ¥ 39,456,912,000 (2010 - ¥ 21,316,000,000)	Yen	Federal Government	2029	0.01 to 2.5%	Yen
IADB 1983AB - US$ 250,000,000 (2009 - US$ 250,000,000)	U.S. dollar	-	2023	2.49% to 2.99%	US$

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Exchange rate as of December 31, 2011: US$ 1.8758; Yen 0.024310 - (December 31, 2010 - US$ 1.6662; Yen 0.0205).

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(a) Banco do Brasil

In March 1994, the Company refinanced the existing loan agreements with Caixa Econômica Federal, which assigned loans rights represented by receivables to the Federal Government, with Banco do Brasil acting as financial agent. Under the agreement entered into with the Federal Government, payments are made based on the Price amortization system, monthly indexed by the Standard Reference Unit (UPR), which is equal to the Government's benchmark Interest Rate (TR), plus interest of 8.5% per year. The interest and principal amount are monthly paid with final maturity in 2014. This financing is guaranteed by the São Paulo State Government by a pledge of its own revenues and revenues of the Company.

(b) Debentures

(i) 8th issue

To terminate the program registered with the CVM on September 17, 2004, the Company issued on June 1, 2005, 700,000 debentures, using the option to increase the number of debentures allowed by up to 20%, distributed in two series, without renegotiation, with the face value of R$ 1 each, totaling R$ 700,000. The date for the financial settlement of the operation was June 24, 2005. Proceeds were used in the settlement of Eurobonds agreement.

The debentures were placed on the market as follows:

Number	Adjustment	Interest	Interest payment	Repayment	Maturity

Series 1	350,000	-	CDI+1.5% p.a.	Semiannual	Single installment	June 2009
Series 2	350,000	IGP-M	10.75% p.a.	Annual	Single installment	June 2011

Interest expense totaled R$ 18,520 and R$ 47,580 in 2009 and 2008, respectively, related to series 1 and R$ 22,742, R$ 49,863 and R$ 44,441 in 2011, 2010 and 2009, respectively, related to series 2.

Series 1 of the 8th issue of debentures was fully repaid on June 1, 2009.

On June 1, 2011 the 8th issue of debentures was fully repaid.

(ii) 9th issue

On October 23, 2008, the Company registered with the CVM a securities program for a total amount of R$ 3 billion and made a Public Offering of Simple Debentures, unsecured and non-convertible, of the 9th issue, in the context of the said program.

The debentures were placed on the market as follows:

	Number	Adjustment	Interest	Interest payment	Repayment	Maturity
Series 1	100,000	-	CDI+2.75% p.a.	Semiannual	Annually (from October 15, 2011)	October 15, 2013
Series 2	100,000	IPCA	12.87% p.a.	Annual	Annually (from October 15, 2013)	October 15, 2015

Repayment will be made in three annual and consecutive installments of the same amount, the first of which falls due on October 15, 2011 for series 1 and October 15, 2013 for the series 2.

Settlement date of series 1 was on November 7, 2008 and of series 2 on November 10, 2008.

The funds arising from this issuance were used to refinance debts falling due.

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Interest expenses totaled R$ 11,896, R$ 12,354 and R$12,546 in 2011, 2010 and 2009, respectively, related to series 1 and R$ 16,486, R$ 16,993 and R$16,120, respectively, related to series 2.

On October 17, 2011 the 9th issue of debentures was fully repaid.

(iii) 10th issue

On November 15, 2009, the Company launched 100 debentures, subscribed exclusively by the National Bank for Economic and Social Development (BNDES). These debentures were distributed in three nonconvertible series, at a nominal value of R$ 2,753, totaling R$ 275,370. This transactions was settled on December 15, 2009, for all series.

The debentures were placed on the market as follows:

	Number	Adjustment	Interest	Interest payment	Repayment	Maturity
Series 1	28	-	TJLP + 1.92% p.a.	Quarterly to November 2012 and monthly from then on	Monthly (from December 2012)	November 2020
Series 2	30	IPCA	9.53% p.a.	Annual	Annual (from December 2013)	December 2020
Series 3	42	-	TJLP + 1.92% p.a.	Quarterly to November 2012 and monthly from then on	Monthly (from December 2012)	November 2020

The funds raised in this issuance will be used in expenditures in water supply and sewage systems in the following projects: Water Treatement Stations at Rio Grande, Litoral Norte, Vale do Paraíba and Mantiqueira, Bacia do Piracicaba-Capivari-Jundiai; and for program of reduction of losses.

In 2011, 2010 and 2009, interest expense related to 10th issue totaled R$ 6,016, R$ 6,016 and R$755, respectively, related to series 1; R$ 8,862, R$ 9,156 and R$207, respectively, related to series 2 and, R$ 9,025, R$ 9,025 and R$1,132, respectively, related to series 3.

Financial covenants

. EBITDA / Net revenue: equal or higher than 38%.

. EBITDA / Financial expenses ratio: equal to or higher than 2.35.

. Net debt / EBITDA: equal to or lower than 3.65.

(iv) 11th issue

On March 1, 2010, the Company launched 1,215,000 debentures. On April 30 and May 3, 2010 the Company settled series 1 and 2, respectively, through a public offering, as summarized below:

	Number	Adjustment	Interest	Interest payment	Repayment	Maturity
Series 1	810,000	-	DI + 1.95% p.a.	Semiannual (September and March)	Annual (from March 2013)	March 201
Series 2	405,000	-	DI + 1.40% p.a.	Semiannual (September and March)	Annual (from March 2012)	March 201

The interest expense related to the 11th issue was R$ 107,081 and R$ 80,077 related to series 1 and R$ 52,369 and R$38,103 related to series 2 in 2011 and 2010, respectively.

(v) 12th issue

The Company issued R$ 500 million in debentures to Government Severance Indemnity Fund for Employees (FGTS). The debentures will be invested in program of structures to comply with the goal to universalize the sanitation service in the State of São Paulo until 2018. Among the programs that will receive this investment are Vida Nova (water sources), Programa Metropolitano de Água (Water Metropolitan Program), Programa Metropolitano de Esgoto (Sewage Metropolitan Program), Programas de Àgua e Esgotos do Interior e Litoral (Water and Sewage Program inside the state and coastal region).

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Initially, R$ 170 million was released and R$ 330 million is invested in a restricted bank account and will be released in 2 installments. The first installment will be released after 6 months and the second installment will be released after 12 months from the issuance date. The condition for releasing these installments is the execution of the investment in these projects by SABESP.

One of the conditions for approving this transaction is the allocation of 60% of the investments in poor areas.

The issuance of the debentures occurred on September 22, 2010 through a public offer under the Brazilian securities exchange commission rules, as follows:

	Number	Adjustment	Interest	Interest payment	Repayment	Maturity
Unique Serie	500,000	-	TR + 9.5% p.a.	Monthly (from July 2010)	Monthly (from July 2014)	June 2025

The interest expense related to the 12th issue was R$ 51,434 and R$ 26,879 in 2011 and 2010, respectively.

Financial covenants of the 11th and 12th issue of debentures:

. Adjusted current ratio (current assets divided by current liabilities, excluding from current liabilities the current portion of noncurrent debts incurred by the Company that are recorded in current liabilities) higher than 1.0.

. EBITDA / financial expenses ratio equal to or higher than 1.5.

. Noncompliance with these obligations will only be typified when verified in the quarterly financial statements for at least two consecutive quarters or two nonconsecutive quarters within a twelve-month period.

In case of noncompliance with the covenants, the trustee should call an extraordinary debentureholers' meeting within 48 hours from the acknowledgement of the noncompliance to resolve on the declaration of accelerated maturity of the debentures.

(vi) 13th issue

On January 11, 2011, the Company registered the 13th issue of simple debentures, nonconvertible, in a unique series with public distribution and strict efforts according to Brazilian Securities and Exchange Commission (CVM), instruction nº 476.

	Number	Interest	Interest payment	Repayment	Maturity
Unique Serie	600,000	DI + 0.65% / 0.75% / 0.85% / 1.25% p.a.	Semi-annualy	Single installment	August 29, 2012

Issue date: January 11, 2011

Series: Unique

Total amount: R$ 600,000

Quantity: 60

Unitary amount: R$ 10,000

Payment: semi-annually

Maturity date: August 29, 2012

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Repayment: Partial or total, any time

Interest: 1st period: January 11, 2011 to February 26, 2011 = 0.65%

2nd period: February 26, 2011 to August 30, 2011 = 0.75%

3rd period: August 30, 2011 to March 1, 2012 = 0.85%

4th period: March 1, 2012 to August 29, 2012 = 1.25%

The amount obtained in the 13th issue of debentures was utilized to repay the 60 promissory notes with maturity date on February 26, 2011. On January 11, 2011 the promissory notes were fully repaid.

Financial covenants

. EBITDA / Financial expenses ratio: equal to or higher than 1.5.

. Total debt / EBITDA: equal to or lower than 3.65.

(vii) 14th issue

On February 15, 2011, the Company launched 100 debentures, subscribed exclusively by the National Bank for Economic and Social Development (BNDES). These debentures were distributed in three nonconvertible series, at a nominal value of R$ 2,753.70, totaling R$ 275,370. This transaction was settled on April 15, 2011, for all series.

The debentures were placed on the market as follows:

	Number	Adjustment	Interest	Interest payment	Repayment
Series 1	28	-	TJLP + 1.92% p.a.	Quarterly to February 2014 and monthly from then on	Monthly (from M
Series 2	30	IPCA	9.19% p.a.	Annual	Annual (from Ma
Series 3	42	-	TJLP + 1.92% p.a.	Quarterly to February 2014 and monthly from then on	Monthly (from M

The funds raised in this issuance will be used in expenditures in water supply and sewage systems in the following projects: Water Treatement Stations at Rio Grande, Litoral Norte, Vale do Paraíba and Mantiqueira, Bacia do Piracicaba-Capivari-Jundiai; and for program of reduction of losses.

In 2011, interest expense related to series 1 was R$ 5,254, related to series 2 was R$ 6,916 and R$ 7,881 related to series 3.

Financial covenants

. EBITDA / Net revenue: equal or higher than 38%.

. EBITDA / Financial expenses ratio: equal to or higher than 2.35.

. Net debt / EBITDA: equal to or lower than 3.65.

(viii) 1st issue - Aquapolo

In August 2011, the joint-controlled entity “Aquapolo” launched 326,732 debentures, the 1st issue of simple debentures, nonconvertible, in a unique series.

	Number	Interest	Payment	Amortization	Maturity
Unique serie F-59	326,732	TR + 8.75% p.a.	Monthly (from December 2013)	Monthly (from December 2013)	Agosto/2029

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(c) Caixa Econômica Federal - Pro-sanitation Program

(i) Water and sewage

Several loan agreements were entered into from 1996 to 2004 under the Pro-Sanitation Program for expanding and improving the water supply and sewage systems of several municipalities of the State of São Paulo and of the City of São Paulo. Loans are collateralized by the collections of the daily billings of water supply and sewage services up to the total amount of the debt.

Contractually established repayment terms range from 120 to 180 months, after the beginning of the repayment period.

The balance of these facilities as of December 31, 2011 was R$ 563,750 (December 31, 2010 - R$ 607,638).

The contractual charges are:

Contract signed in	**1996**	**1997**	**1998 to 2004**
Interest rate	9.5% p.a.	6.5% to 8.0% p.a.	6.5% to 8.0% p.a.
During grace period: Risk rate			

	1.0% p.a. on amount disbursed	1.0% p.a. on amount disbursed	0.6% p.a. or 2% p.a. on outstanding debt balance
Management fee	0.12% p.m. on the contract amount	2.0% p.a. on amount disbursed	1.0% p.a. on amount disbursed or 2% p.a. on debt balance for contracts entered into in 2003 and 2004
During repayment period :			
Management fee	Difference between installment calculation and a 10.5% p.a. rate less the 9.5% p.a. rate	1.0% on the debt balance	1.0% on the debt balance

(ii) Pró-Sanear Program

In 1997, 1998 and 2008, contracts were signed under the Pró-Sanear Program for the improvement of water and sewage services, with the involvement of the communities receiving the services, in several municipalities of the Metropolitan Region of São Paulo. The credit facilities are collateralized by the collections of the daily billings of water supply and sewage services up to the total amount of the debt. Repayment will be made in 180 months after the beginning of the repayment period. As of December 31, 2011, the balance was R$ 14,448 (December 31, 2010 - R$ 16,752).

The financial charges are:

. interest rate - 5.0% p.a.;

. management fee (grace period) - 2.0% p.a. on debt outstanding balance;

. management fee (repayment phase) - 1.0% p.a. on debt outstanding balance;

. risk rate (grace period) - 1.0% p.a. on amounts disbursed.

(iii) Growth Acceleration Program (PAC)

In 2007 and 2008, the Company entered into agreements linked to the Universal Water and Sewage Services were entered with several municipalities, with funds from the Government Severance Indemnity Fund for Employees (FGTS). The credits facilities are guaranteed by a monthly flow of the billings corresponding to the minimum of three

times the monthly charge. Repayments will be made in 240 months after the beginning of the repayment period. The balance as of December 31, 2011 was R$ 440,733 (December 31, 2010 - R$ 250,067).

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The financial charges are:

. interest rate - 6% p.a.;

. management fee - 1.05% p.a. during the period of the contract;

. risk rate - 0.3% p.a. on the adjusted debt balances.

Covenants

An Agreement for Performance Improvement sets targets for financial indicators (billing losses, revenue evasion, cash and cash equivalents and reduction of the number of days of committed receivables), and operating indicators that, based on the past two years, are annually projected for the following five years.

Noncompliance with 4 of the 8 covenant clauses will accelerate the maturity of the contract.

(d) BNDES

Contract 01.2.619.3.1 - Entered into in August 2002, totaling up to R$ 60,000, for the purpose of financing part of the Company's contribution to the Tietê River Pollution Abatement Project - Stage II, related to loan agreement 1212/OC

- BR with the Inter-American Development Bank (IADB). The related project is in progress and the outstanding balance as of December 31, 2011 was R$ 11,638 (December 31, 2010 - R$ 20,980).

The related project is in performance of works stage and the debt balance as of December 31, 2011 was R$ 29,407 (December 31, 2010 - R$ 62,941). The funds are onlent from BNDES to the agents and from the latter to SABESP. The onlending agreement has the same purpose as the agreement between BNDES and SABESP, and the same interest and repayment terms, as follows:

Interest - TJLP limited to 6% p.a., plus a 3% p.a. spread, paid quarterly during the grace period and monthly in the repayment period. The TJLP portion exceeding 6% p.a. will be added to the debt outstanding balance.

Repayment of borrowings was initiated in September 2005, with monthly payments, and conclusion scheduled for February 2013.

Loans are collateralized by part of revenues from the provision of water and sewage services.

Covenants

. Adjusted current ratio: higher than 1.0.

. Ebitda/Net Operating Revenue: equal to or higher than 38%.

. Total connections (water and sewage)/own employees: equal to or higher than 520.

. EBITDA/Debt Service cost: equal to or higher than 1.5.

. Equity / Total Liabilities: equal to or higher than 0.8.

Noncompliance with covenants will accelerate the maturity of the contract.

The Company obtained from BNDES the suspension for 13 months of the compliance of covenants as from December 2011.

(e) BNDES Baixada Santista

In November 2007, the Company entered into a financing agreement with BNDES for the Environmental Recovery Program of the Santos Metropolitan Region, totaling R$ 129,973 with interest of 2.5% p.a. plus TJLP limited to 6%.

Repayment will be made in 96 monthly, consecutive installments, starting January 2012 to December 2019.

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A portion of the Company's revenue is pledged as guarantee for this financing.

The agreement is in progress and the debt balance as of December 31, 2011 and 2010 was R$ 130,474 and R$ 130,474.

(f) Receivables Investment Funds (FIDC – SABESP I)

On March 23, 2006, a single series of senior shares and 26 subordinated shares, held in a deposit account in the name of its holders, were issued with unit value on issue date corresponding to R$ 500. The senior shares are being repaid in 54 monthly installments, starting October 2006, and their final maturity is in March 2011. In March 2011 the FIDC was totally repaid.

The Fund is managed by Caixa Econômica Federal and its custodian and recording agent is Banco do Brasil S.A.

The funds raised, totaling R$ 250 million, were used by the Company to settle debts in 2006.

(g) Financial leasing

The Company signed contracts of assets rental with some suppliers which consist in constructing an infrastructure by the supplier and rent this construction to SABESP. After finishing the contract the infrastructure will be transferred to SABESP. During the construction phase, the Company recognizes an intangible assets and the related liability at fair value. The conclusion of the construction is estimated to June 2013.

When the construction is completed, the Company starts to pay the rental (192 installments) and the lease is updated accordingly to the contract.

On December 31, 2011, there were no constructions completed.

(h) Eurobonds

On November 3, 2006, the Company issued Eurobonds abroad (Eurobonds 2016) totaling US$ 140 million. The issue was led by Deutsche Bank Trust Company Americas and the principal agent was Deutsche Bank Luxembourg S.A. The interest rate is 7.5% p.a., paid semiannually, and maturity is in November 2016. As mentioned in item (i) above, the funds raised were used for the early repayment and partial issue of US$ 225 million in the Eurobonds, with final maturity in June 2008, and the amount redeemed was US$ 126,948 thousand.

As of December 31, 2011 the balance of the Eurobonds was R$ 262,067 equivalent to US$ 140,000 thousand (December 31, 2010 was R$ 232,612), net of cost to issue of R$ 546, which will be amortized until the maturity date.

Covenants - for Eurobonds 2016.

Limit new debt so that:

. adjusted total debt to EBITDA does not exceed 3.65;

. the Company's debt service coverage ratio, determined on the date this debt was incurred, shall not be lower than 2.35.

On December 9, 2010, the Company issued a US$ 350 million senior unsecured notes due 2020 (the Eurobonds 2020). The interest rate is 6.25% p.a., paid semi-annually and maturity date in December 2020. The funds were used for partial repayment of outstanding debts of the Company.

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As of December 31, 2011 the balance of the Eurobonds was US$ 350,000 thousand, equivalent to R$ 649,024 (December 31, 2010 was R$ 576,107), net of cost to issue of R$ 7,507, which will be amortized during the period of the contract.

Noncompliance with covenants will accelerate the maturity of the contract.

(i) Inter-American Development Bank (IADB)

Loan Agreement 713- In December 1992, the Company entered into a loan agreement with the IADB for US$ 400 million to finance the first stage of the Tietê River Pollution Abatement Project. The repayment period started in June 1999 in semiannual installments, subject to annual floating rate interest, varying according to the loans raised by the Bank in each six-month period, and final maturity in December 2017. In December 1992, the Federal Republic of Brazil signed a guarantee contract with the IADB guaranteeing the funds for the fulfillment of the contractual obligations. The outstanding balance as of December 31, 2011 was US$ 150,658 thousand, equivalent to R$ 282,605 (December 31, 2010 - R$ 290,019).

Loan Agreement 896- In December 1992, the Company entered into a loan agreement with the IADB for US$ 50 million to finance the first stage of the Tietê River Pollution Abatement Project. Semiannual repayments started in June 1999, with annual interest of 3% and final maturity in December 2016. In December 1992, the Federal Republic of Brazil signed a guarantee contract with the IADB guaranteeing the funds for the fulfillment of the contractual obligations. The outstanding balance as of December 31, 2011 was US$ 13,889 thousand, equivalent to R$ 26,053 (December 31, 2010 - R$ 27,770).

Loan Agreement 1,212- In July 2000, the Company entered into a loan agreement with the IADB for US$ 200 million to finance the second stage of the Tietê River Pollution Abatement Project. In 2008, total disbursement for this agreement was US$ 2,434 thousand and there are no amounts to be disbursed. The loan is being amortized semiannually and final maturity in July 2025. Interest is being paid on a semiannual basis, based on daily balances, at an annual variable rate according to the costs of loans of the Bank in the preceding six-month period, plus a spread, and changes every six months. The debt balance as of December 31, 2011 was US$ 143,893 thousand, equivalent to R$ 269,915 (December 31, 2010 - R$ 256,880).

Loan Agreement 2,202/OC-BR– On September 3, 2010 the Company and the Inter-American Development Bank (Banco Interamericano de Desenvolvimento or BID) signed the contract for partially finance the third stage of the Tietê River Project, denominated the decontamination of the Tietê river. The total estimated cost of this investment is US$800 million, of which US$ 600 million will be financed by the BID and US$ 200 million will be invested by the Company´s own resources. The final maturity of the loan is in 25 years and the repayment period commences in September 2016.The interest is based on USD-Libor.

On March 17, 2011, the Company received US$1,829 thousand, corresponding to R$ 3,044. This amount will be utilized in the recovery of the Tiete river basin, located in the metropolitan region of São Paulo. The maturity date is 2035.

On December 31, 2011, the total amount of this contract was US$ 78,422 thousand, corresponding to R$ 145,159, net of cost to issue amounting to R$ 1,944, which will be amortized during the period of the contract.

Covenants

. Loan agreements 713, 896 and 1,212 - Tariffs must: (a) produce revenues sufficient to cover the system's operating expenses, including administrative, operating, maintenance, and depreciation expenses; (b) provide a return on property, plant, and equipment no less than 7%; and (c) during project execution, the balances of short-term loans must not exceed 8.5% of total equity.

Noncompliance with covenants will accelerate the maturity of the contract.

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(j) Japan International Cooperation Agency – JICA ("JBIC")

On August 6, 2004, the Company entered into a financing agreement with the JBIC - Japan Bank for International Cooperation, actual JICA, amounting to ¥21,320 million, equivalent to approximately R$ 337,687, for the Environmental Recovery Program of the Santos Metropolitan Region. Total financing period is 25 years, with a seven-year grace period and 18 years of repayment in semi-annual installments. Interest is being paid on a semiannual basis since 2006, and is 2.5% p.a. for the sewage network and 1.8% p.a. for sewage treatment facilities.

On February 15, 2011, the Company signed a complementary agreement with JICA (Japan International Cooperation Agency), former JBIC, for the Environmental Recovery Program of the Santos Metropolitan Region amounting to ¥ 19,169 million, equivalent to R$ 375,904 as of March 31, 2011. The agreement last 18 years and the interest rate vary from 1.8% to 2.5% per annum.

The balance of this loan agreement as of December 31, 2011 was R$ 958,733 (December 31, 2010 - R$ 436,978).

(k) AB Loan (IADB 1983AB)

On May 27, 2008, the Company entered into a loan agreement AB loan with IADB, totaling US$ 250.0 million, which was fully disbursed in June 2008. The funds obtained were used to settle Eurobonds 2008 and to partly perform the Company's investment plan.

The characteristics of this loan agreement are as follows:

	US$	Repayment from	Maturity	Interest (LIBOR + spread)
1983 A	100.0 million	May 2011	May 2023	Libor + 2.99%
1983 B1	100.0 million	May 2011	May 2020	Libor + 2.69%
1983 B2	50.0 million	May 2011	May 2018	Libor + 2.49%

Interest is being paid on a semiannual basis since November 2008. The balance of this loan agreement as of December 31, 2011 was US$ 226.0 million, equivalent to R$ 421,266 (2010 - R$ 413,468), net of debt issuance costs, totaling R$ 2,771 (2010 - R$ 3,080), which will be repaid over the agreement term.

(l) Promissory notes

On May 3, 2010, the Company fully paid the 4th issue of promissory notes.

On August 30, 2010 was issued Promissory Notes amounting to R$600,000 as a bridge loan, related to an advance to the 13th issue of debentures.

The amount obtained from the 13th issue of debentures was fully used to repay the 60 promissory notes of the 5th issue of the Company which had maturity date on February 26, 2011. On January 11, 2011 the 5th issue of promissory notes was fully repaid.

(m) International Bank for Reconstruction and Development - IBRD

On October 28, 2009, the Company and "The World Bank" – Banco Internacional para Reconstrução do Desenvolvimento (BIRD) signed a contract (the BIRD agreement 7662BR) amounting to US$ 100,000 thousand. On December 31, 2011, the total amount was US$10,316 thousand equivalent to R$ 18,928, net of cost to issue of R$ 424, which will be amortized during the period of the contract.

(n) Covenants

As of December 31, 2011 and 2010, the Company had met all the requirements set forth by its loan and financing agreements.

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The Company obtained from BNDES, for special purpose, the suspension for 13 months of the compliance of covenants as from December 2011.

(o) Maturities of loans and financing

The following table provides the maturities of loans and financing as of December 31, 2010:

	2012	2013	2014	2015	2016	2017	2018 to 2035	Total
In local currency	1,440,633	1,057,490	574,884	485,664	219,927	222,304	1,541,971	5,542,874
In foreign currency	189,377	169,707	169,707	169,707	431,774	172,360	1,750,789	3,053,421
Total	1,630,010	1,227,197	744,591	655,372	651,701	394,664	3,292,760	8,596,295

13 Other Taxes Payable

	Current		Noncurrent	
	December 31, 2011	December 31, 2010	December 31, 2011	December 31, 2010

COFINS and PASEP	57,073	48,149	-	-
PAES (tax debt refinancing program)	36,716	35,364	18,363	53,045
INSS (Social Security contribution)	25,645	24,112	-	-
IRRF (Withholding taxes)	44,172	34,572	-	-
Other	17,516	15,853	-	-
Total	181,122	158,050	18,363	53,045

The Company applied for enrollment in PAES on July 15, 2003, in accordance with Law Nº 10684 of May 30, 2003, and included in its application the debts related to COFINS and PASEP which were involved in a legal action challenging application of Law 9718/98, and the outstanding balance under the Tax Recovery Program (REFIS). The original amount included in PAES in July 2003 was R$ 316,953, as follow:

Tax	**Principal**	**Fine**	**Interest**	**Total**
COFINS	132,499	13,250	50,994	196,743
PASEP	5,001	509	2,061	7,571
REFIS	112,639	-	-	112,639
Total	250,139	13,759	53,055	316,953

The loan related to PAES is being paid in 120 months. The amounts paid in 2011, 2010 and 2009 were R$ 36,091, R$ 34,744 and R$ 33,386, respectively, and financial expenses of R$ 2,761, R$ 4,112 and R$ 5,585, respectively, were recorded. The outstanding balance as of December 31, 2011 and 2010 was R$ 55,079 and R$ 88,409, respectively. The assets offered as guarantee in REFIS, totaling R$ 249,034, are still guaranteeing the amounts in the PAES program.

14 Deferred Income Taxes

Breakdown of deferred taxes

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	December 31, 2011	December 31, 2010
Deferred income tax assets (i)		
Provisions	575,473	539,394
Pension obligations – G1	180,018	162,552
Pension obligations – G0	85,271	85,271
Donations of underlying assets on concession agreements	38,213	38,213
Allowance for doubtful account	135,223	129,248
Other	78,717	50,108