

FUND LAUNCHED

**2005**

FUNDS UNDER  
MANAGEMENT

**£519.4**  
MILLION

NET ASSET VALUE  
PER SHARE

**435.7%**  
SINCE INCEPTION\*



# Water for all: How Sabesp's success benefits São Paulo's population, economy, government, and investors

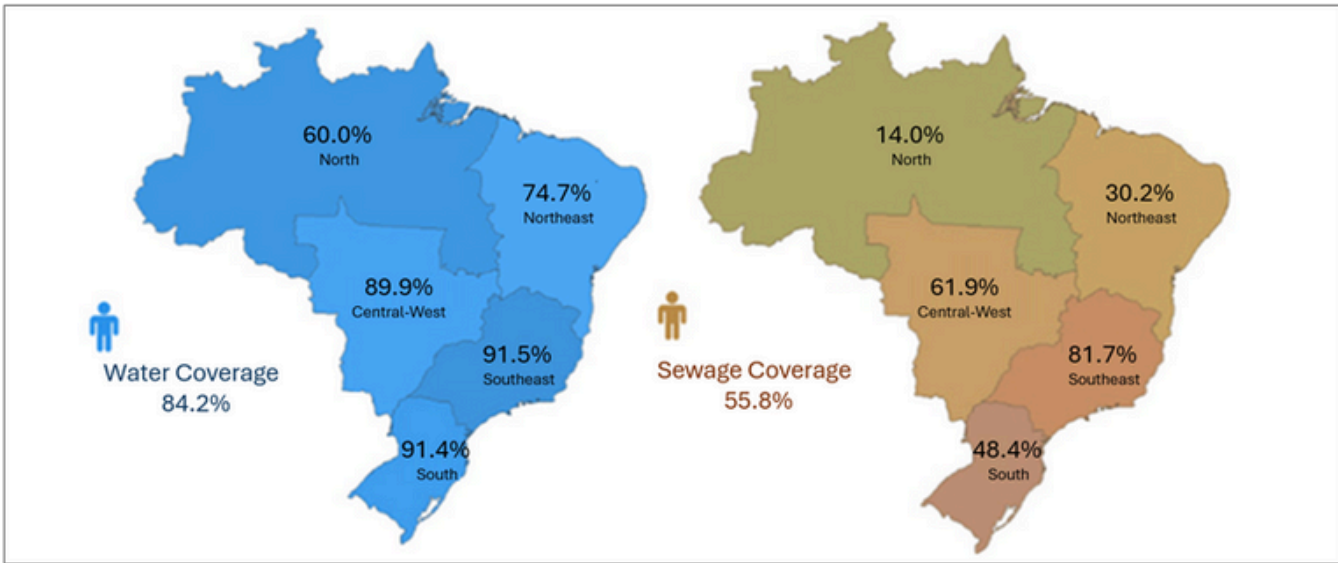
October 2024

As the world rapidly advances with innovations like artificial intelligence reshaping industries and everyday life, it is paradoxical that many regions still lack access to basic services such as water and sanitation. Globally, about 2.2 billion people lack access to clean, potable water, and 4.2 billion people do not have access to safely managed sanitation services.<sup>1</sup> In the developing world, this gap is often due to complex regulatory environments that fail to create the right incentives for investment, political and governance issues, rapid urbanisation and economic constraints. However, we are now witnessing structural changes in some countries, where governments are establishing sound regulatory frameworks that create significant opportunities for private investors.

Brazil, with a population exceeding 215 million, faces significant challenges in this sector. Despite some progress, about 16% of the population still lacks access to safe drinking water, and nearly 54% are without sewage services as of 2022.<sup>2</sup> These deficiencies are exacerbated by pronounced regional disparities, reflecting the urgent need for investment and development. The Brazil National Sanitation Plan (Plansab) aims for universal access to water and sanitation services by 2033. Achieving this ambitious goal requires an estimated BRL 900 billion (approximately USD 160 billion) in investments.<sup>3</sup> The New Sanitation Legal Framework, enacted in 2020, represents a pivotal shift by encouraging private sector participation through clearer regulatory guidelines and targets for universal access, opening the door for increased investment in the sector.

# Water for all: Sabesp

October 2024

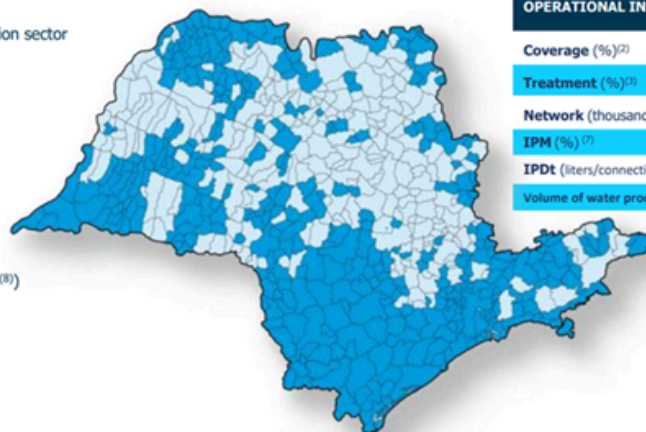


Source: SNIS 2021<sup>4</sup>

In a sector characterised by high investment needs and opportunities, Sabesp stands out and is currently among the top 10 investments of UEM. Sabesp is one of the largest water and sewage service providers globally, ranking as the second largest sanitation company by revenue and the third largest by population served. The company alone accounts for over 30% of all sanitation investments made in Brazil.

Sabesp operates in 376 municipalities across the state of São Paulo, serving approximately 28 million people. The company manages an extensive network, including 93,500 kilometres of water distribution and 63,900 kilometres of sewage collection networks. Headquartered in São Paulo state - which, if considered a country, would rank as the 21st largest economy globally and represents 31% of Brazil's GDP. Sabesp was formerly controlled by the São Paulo State Government and was privatised in July 2024.

-  Main Brazilian company in the sanitation sector
-  Low operating risk
-  Natural monopoly
-  375 municipalities served (URAE-1 southeast + 4 municipalities<sup>(6)</sup>)
-  Number of employees: 10,158



OPERATIONAL INDICATORS <sup>(1)</sup>	WATER	SEWAGE
Coverage (%) <sup>(2)</sup>	98	93
Treatment (%) <sup>(3)</sup>	-	85%
Network (thousand km) <sup>(4)</sup>	93.5	63.9
IPM (%) <sup>(5)</sup>	29.2	-
IPDt (liters/connection x day)	262	-
Volume of water produced in the quarter <sup>(5)</sup>	770	-

**28.1 million consumers**  
supplied directly with water

**24.9 million consumers**  
Served directly with sewage collection

**0.6 million**  
of customers supplied wholesale<sup>(6)</sup>

(1) Does not include Olímpia  
(2) Consider a variation margin of ± 2 p.p.

(3) Consumer units connected to the sewage treatment  
(4) Water: includes water mains / Sewage - includes ocean outfall and trunk collectors (dec/23)

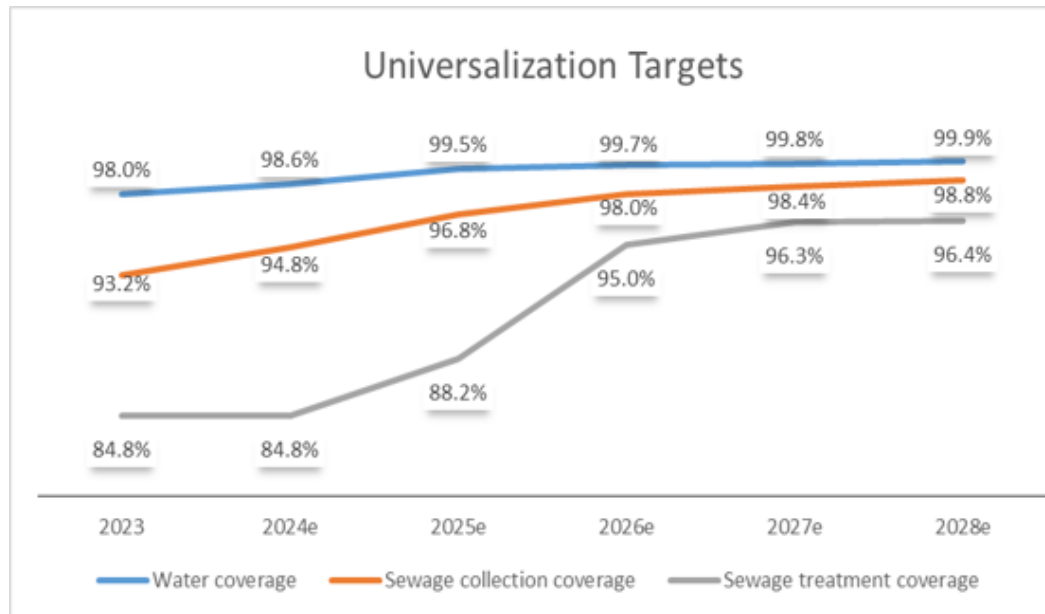
(5) In millions of m<sup>3</sup>  
(6) Moji das Cruzes and São Caetano

Source: Sabesp

# Water for all: Sabesp

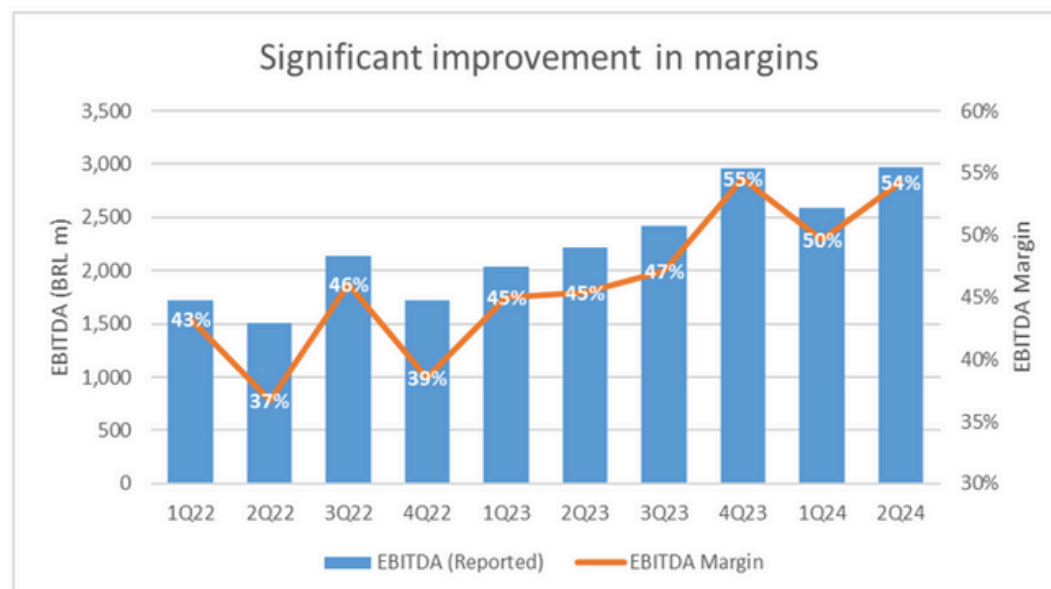
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Sabesp's privatisation was a top priority for the São Paulo state government, strongly advocated by Governor Tarcísio de Freitas, who began his term in 2023. His administration aimed to expedite the universalisation of water and sewage services in the state, advancing the target from 2033 to 2029. As a state owned enterprise (SOE), Sabesp would have struggled to meet this ambitious timeline due to financial and operational constraints. The reduction in the state's ownership from 50.3% to 18.0% resulted in the government losing control of the company, which was seen as a necessary step to attract private investment and enhance service efficiency under the new regulatory framework.



Source: Sabesp, URAE regional plan

Sabesp's turnaround story began even before privatisation. In 2023, a newly appointed management team introduced several efficiency measures, resulting in 35% YoY growth in EBITDA for LTM 2Q24, while margins improved by 760 bps. A key initiative was a voluntary dismissal program, which reduced the number of employees from 12,299 in 2022 to 10,158 in 2Q24, a decrease of 2,141 employees or 17.4%. As a result, personnel expenses as a percentage of net revenue decreased from 17.6% in 4Q22 to 13.7% in 2Q24. Post privatisation, we anticipate significant margin gains to continue, as Sabesp previously faced limitations in cost cutting as a state owned enterprise.



Source: Sabesp, ICM

# Water for all: Sabesp

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The privatisation process, conducted through a 100% secondary follow-on offer on July 22, 2024, raised BRL 14.8 billion, a record demand high in Brazil. Equatorial Group emerged as the strategic shareholder, acquiring a 15% stake for BRL 6.9 billion. Under the agreement, Equatorial will appoint three board members (including the chairman) and the CEO, securing significant influence over the company's strategic direction. To facilitate a smooth transition, and to encourage commitment from the strategic shareholder, the privatisation included a lock up period until December 2029 for the shares acquired by Equatorial, along with non compete clauses granting Sabesp exclusivity for investments within São Paulo state and priority for investments outside the state.

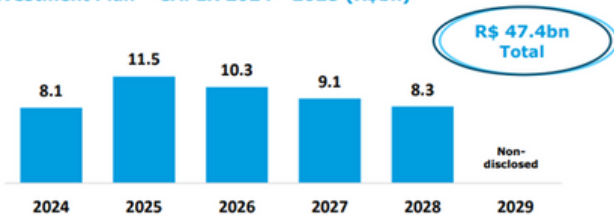
Equatorial's management is highly regarded, leading one of Brazil's top utility platforms with a market cap of BRL 40 billion. They have a strong track record of turning around distressed assets, successfully managing energy distribution concessions such as Cemar in Maranhão and Celpa in Pará. Since the company's IPO in 2006, Equatorial's shares have delivered a total return of over 3,500%, significantly outperforming the local index by more than 15 times. Looking ahead, value creation from Sabesp will emerge on further efficiency gains and growth. Having Equatorial leading this new cycle gives us strong confidence in the company's prospects.

In terms of efficiency, there is substantial room for improvement in areas like personnel, services, water loss and energy costs. Sabesp currently operates with manageable costs per water and sewage connection that are twice as high as those of Aegea, the largest private sanitation company in the country prior to Sabesp's privatization. Given its scale and operational leverage, Sabesp is expected to achieve even better results. On the revenue side, eliminating consumer discounts and addressing billing/metering errors are expected. Additionally, there is considerable potential to reduce bad debt expenses, which have been around 3.0% of gross revenue, compared to the regulatory ratio of 1.65% set in the first tariff cycle. Any efficiency gains the company achieves will be 100% retained until 2029. From 2030 onward, efficiency gains will be shared with consumers at the following percentages: 50% from 2030 to 2034, 75% from 2035 to 2039, and 90% from 2040 onward.

Sabesp's remuneration is based on its Regulatory Asset Base (RAB), which is expected to increase significantly given the robust investment pipeline expected over the next five years. To achieve the universalisation target, Sabesp is expected to invest over BRL 70bn in this period, nearly doubling its RAB. Sabesp's investments will be incorporated into its RAB annually until 2035, enabling sustained tariff increases and allowing the company to quickly monetise its investments. The São Paulo state government has also established a special fund (FAUSP) to address public concerns about potential tariff hikes. This fund, financed by at least 30% of the privatisation proceeds and future dividends received by the state, aims to mitigate tariff impacts for vulnerable consumers and provide assistance during extreme weather events.

## Pre-privatization: universalization in 2033

### Investment Plan – CAPEX 2024 - 2028 (R\$bn)



## Post-privatization: universalization in 2029

### CAPEX for Universalization (R\$bn)



Source: Sabesp

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Companies in the water and sewage sector are regulated by regional authorities. Until 2024, the existing regulations did not incentivise Sabesp to invest or pursue greater efficiency, as the company could not retain the benefits of efficiency gains. This made universal service coverage challenging and led to a return on invested capital (ROIC) much lower than its potential. Consequently, Brazilian sanitation companies have historically traded below their RAB, with Sabesp enterprise value (EV) trading at around 0.75x its RAB pre-privatisation. The new regulatory framework introduced with privatisation represents a significant improvement, reducing the discretionary power of the regulatory agency and encouraging both capital expenditure and efficiency measures. As a result, we have seen the shares re-rate to slightly above 1.0x, with the potential to reach levels above 1.3x, in line with the energy distribution sector that has experienced an improved regulatory framework for many years.

Sabesp's investment thesis combines defensive characteristics inherent to the sector with a robust growth pipeline poised to deliver substantial value to shareholders, alongside being potentially one of the most significant turnaround stories in Brazil. Once the company is confident that it is on track to meet universalisation targets in São Paulo state, we will gain a clearer understanding of what to expect beyond these milestones—whether it be further growth, higher dividends, or a combination of both. Sabesp's strong balance sheet may enable the company to expand into other regions of the country that face significant challenges in service coverage. Given its size and the support of Equatorial, Sabesp is positioned to be the leading player in addressing Brazil's water and sewage gap. We see recent developments in the company and the sector as just the beginning, with Sabesp offering substantial long term value creation for investors and the potential to be a long term compounder. Shares have performed strongly since January 1, 2023, delivering a total return of 65.5% through to September 30, 2024, significantly outperforming the local index, which returned 20.1% over the same period. Despite this impressive performance, we still find the company trading at attractive multiples and well positioned among UEM's top 10 holdings.

## Eduardo Greca

11 October, 2024

Source Data: ICM Limited

[1] Water and Sanitation | Department of Economic and Social Affairs (un.org)

[2] Painel Saneamento Brasil - [www.painelsaneamento.org.br](http://www.painelsaneamento.org.br)

[3] ABCON - Associação e Sindicato Nacional das Concessionárias Privadas de Serviços Públicos de Água e Esgoto

[4] SNIS - Sistema Nacional de Informação sobre Saneamento

\*Total return is calculated based on undiluted Net Asset Value, plus dividends reinvested and adjusted for the exercise of warrants and subscription shares

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