CtW Investment Group

May 8, 2015

Mr. John H. Herrell
Lead Independent Director and
Chairman of the Audit Committee
Universal Health Services, Inc.
P.O. Box 61558
367 South Gulph Road
King of Prussia, PA 19406

Dear Mr. Herrell,

Since our letter to you dated April 8, 2014, UHS's River Point Behavioral Health facility in Florida has had payments from the Medicare and Medicaid programs suspended , a suspension that is still in effect. Moreover, the coordinated federal false claims investigation that we raised concerns over in our letter has now expanded its scope to 21 facilities, with subpoenas seeking records as far back as 2006. But most troubling of all, on March 31, 2015 UHS disclosed that the corporation as a whole is now subject to a criminal investigation led by the Department of Justice's Criminal Fraud Section.

Additionally, we have noticed that over the past five years, UHS has made substantial reductions to its reserve for general and professional liabilities. Due to these reductions, UHS's reserve balances are at an all-time low of 2.1% of total assets, or $192.9 million, while many of the company's peers have increased reserves from 2013 to 2014.[i] Moreover, these reductions boosted UHS's earnings per share and enabled the company to meet or beat analyst consensus expectations in several of the corresponding periods. However, the risk inherent in these reserve reductions manifested in Q3 2014 when UHS recognized a material charge to earnings due to a larger than expected settlement. In the quarter leading up to the settlement, the total amount accrued for UHS's professional and general liability claims was the lowest it had been in the past seven years.

In light of these developments, it is incumbent upon you and your fellow directors to explain to shareholders what steps the board intends to take in order to minimize the exposure of long-term shareholders to the risks of regulatory enforcement and associated litigation, including risks associated with inadequate general and professional liability reserves.

In particular, you should step forward at this year's annual shareholders meeting and explain:

- Why UHS continues to resist the creation of a dedicated compliance and quality of care committee at the board level, despite the audit committee's apparent inability to grasp the seriousness of the allegations UHS faces, an inability made all too apparent by the contrast between the rosy view of compliance oversight provided in your response to us and the actual adverse developments over the past year.

- How the Audit Committee is currently overseeing company efforts to understand why UHS as a corporate entity is now the subject of a federal criminal investigation, and what changes to its compliance program will be necessary to avoid similar investigations in the future.
- What steps the company is taking to ensure that it has adequate reserves against enforcement and litigation related losses, so that any fines, penalties, or other costs do not surprise the market and generate excessive losses for shareholders.

We are deeply disturbed by the developments at UHS over the past year, and by you and your fellow directors' failure to heed our warning that the risk of enforcement action was unnecessarily high. We hope that you are now willing to undertake the steps necessary to protect long-term shareholders, and look forward to hearing your explanation of the board and Audit Committee's plan to improve regulatory oversight at the annual meeting.

Expansion of Federal Investigation to UHS Itself

In our letter dated April 8, 2014 we urged you and you and your fellow directors to take immediate steps to improve the UHS board's oversight of regulatory compliance, including the creation of a new, board-level committee charged with overseeing regulatory compliance and quality of care, a step that most of UHS's publicly-traded peers have already taken. We noted that multiple state and federal investigations of UHS facilities, together with the evident divergence of UHS's billing practices from those of its peers - which we illustrated in the case of a suicidal ideation diagnosis - suggested a substantial and unaddressed risk to long-term shareholders. In particular, we suggested that the board's lack of focus on overseeing regulatory compliance could result in significant and costly enforcement actions and settlements.

In your response, you assured us that the board effectively oversees UHS's compliance program, that this program is robust, that our analysis of UHS billing practices did not imply any significant, unaddressed risks going forward, and that the creation of a separate, dedicated compliance committee was unnecessary. You also noted in that "While a small minority of our facilities may encounter sporadic regulatory compliance issues, those matters are always remedied. UHS has never had a facility lose its license or Medicare/Medicaid certification."

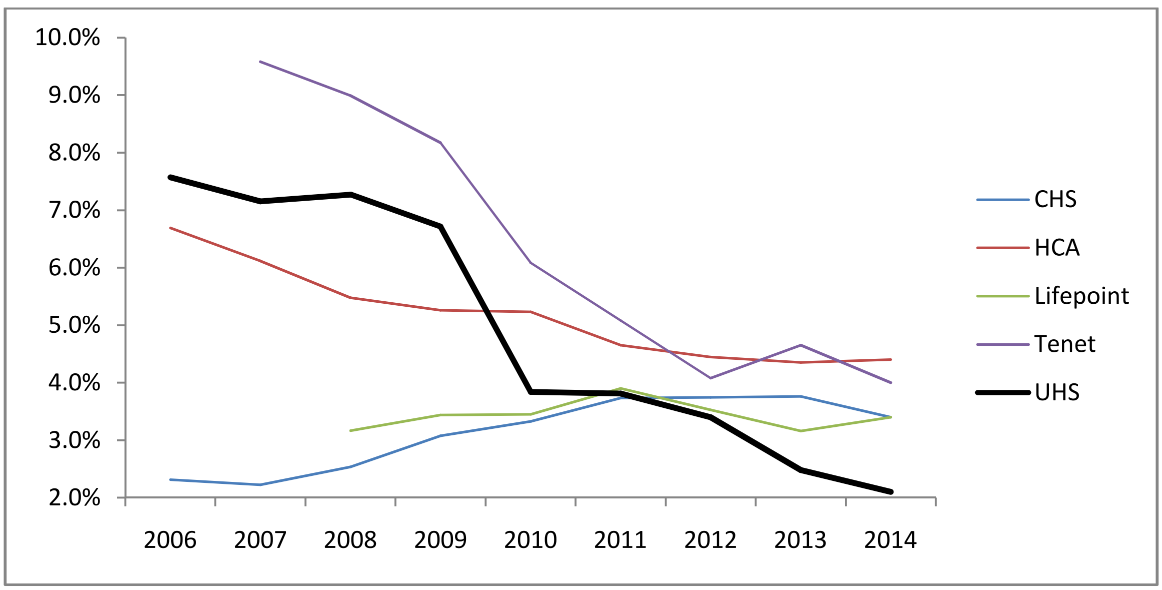
As noted above, shortly after we received your reply, UHS's River Point Behavioral Health facility in Florida had payments suspended by the Medicare and Medicaid programs, the federal false claims investigation was expanded to 21 facilities, and most recently, in March 2015, UHS disclosed that the corporation as a whole is now subject to a criminal investigation led by the Department of Justice's Criminal Fraud Section. Additionally, UHS disclosed that Rock River Academy is scheduled to close in Q2 2015[ii] after the Illinois Department of Children and Family Services stopped placing juvenile wards in the facility.[iii]

These developments only reinforce the concerns we expressed in our letter last spring, that the Audit Committee of UHS lacks adequate focus on and experience with oversight of regulatory compliance, and that long-term shareholders would be better served if the board followed its peers and created a separate committee charged with overseeing compliance and quality of care. Given that it now appears that the Audit Committee has also tolerated questionable and risky changes in accounting practices, we are more convinced than ever that a restructuring of the board and its committees is necessary in order to protect the interests of long-term shareholders.

UHS Reduced Reserves for Professional and General Liabilities Seven Times over the Past Five Years

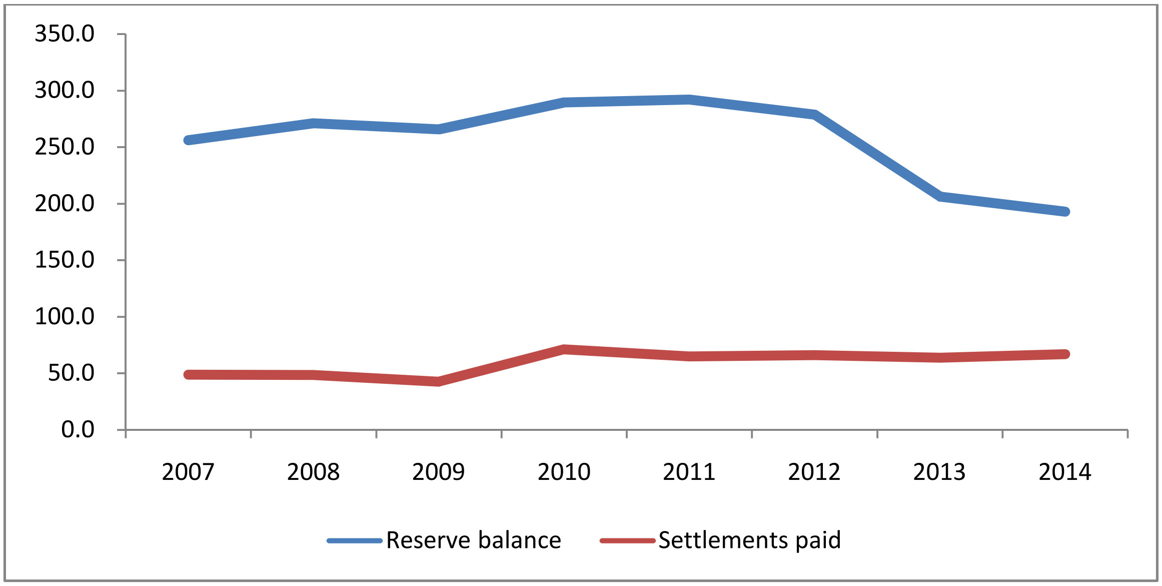
Over the past five years, UHS has repeatedly reduced its reserve for general and professional liabilities, reductions that now total $188 million. These reductions are itemized in Table 1, in the Appendix to this letter. We believe that these reductions have unnecessarily exposed shareholders to considerable financial risk. This belief is supported, in part, by the contrast between UHS's reserve practices and those of its peers. As Chart 1 below indicates, UHS's reserve balance, measured as a percent of the company's total assets, has not only been steadily declining, but is noticeably lower than that of any of its publicly traded hospital peers.

Chart 1. Reserve balance as a percent of total assets, for each publicly traded hospital



Moreover, the decline in the balance in UHS's general and professional liability self-insurance reserves has outpaced that of the settlement amounts the company has had to pay, as depicted in Chart 2.

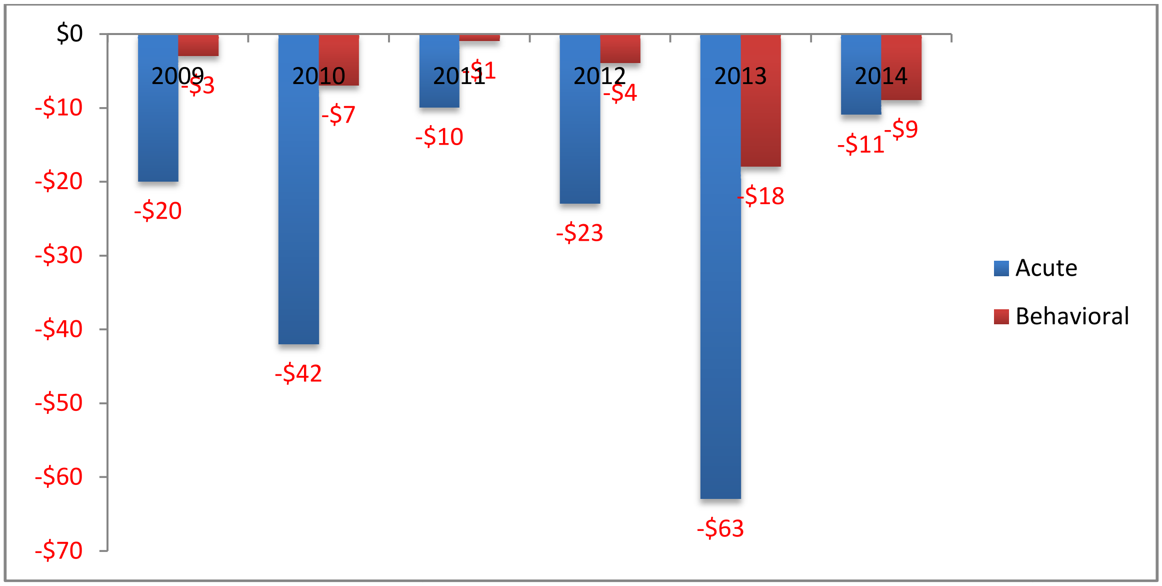
Chart 2. UHS professional and general liability self-insurance reserves: balance and settlements paid



Second, we note that UHS has twice changed its methodology to estimate future claims payments, in 2010 and 2013. In 2010, UHS increased "weighting given to company-specific metrics (to 75% from 50%), and decreased general industry metrics (to 25% from 50%), related to projected incidents per exposure, historical claims experience and loss development factors."[iv] Three years later, UHS revised its methodology to eliminate all reference to industry metrics, with "an increased weighting given to company-specific metrics (to 100% from 75%), and decreased general industry metrics (to 0% from 25%)."[v] UHS justified its weighting changes because the growing number of facilities operated by the company provided for a "statistically significant data group," and also because its "historical professional and general liability experience…has developed favorably as compared to general industry trends."[vi]

Chart 3 displays UHS's allocation of the reserve reductions to its two primrary business segments, acute care hospital services and behavioral services. As Chart 3 shows, 85% of the reductions in 2010 and 78% of the reductions in 2013 were allocated to UHS's acute care segment. UHS operates just 24 acute care hospitals[vii] out of an estimated 5,000 community hospitals in the United States[viii] and we find it hard to believe that this small sample represents a "statistically significant data group" as UHS asserts.

Chart 3. Reductions in UHS's professional and general liability self-insurance reserves, by segment



Reserve Reductions Positioned UHS To Meet Or Exceed Analysts' Consensus EPS Estimates.

Table 2 below illustrates the impact of these reserve reductions on UHS's reported earnings per share (EPS). In the seven quarters since 2010 during which UHS reduced its professional and general liability reserve, UHS three times avoided missing the analyst consensus estimate for its EPS solely as a result of the reserve reduction's impact. Additionally, in one other quarter - when UHS's reported EPS without the reserve reduction impact exactly matched the consensus analyst estimate - UHS was able to announce that it beat the consensus by 7 cents a share. Additionally, in the first two reductions during 2010, UHS was able to significantly reduce the margin by which its earnings missed the analysts' estimate: for Q2 2010 the miss was reduced from 12 cents to 2 cents per share, and in Q4 2010 the miss was reduced by 18 cents a share.

Table 2. Impact of reductions in UHS's professional and general liability self-insurance reserves on EPS

Year	Quarter	Reduction amount	Reduction % of NI	EPS	EPS without reduction	Consensus estimates	Impact on consensus
2010	Q2	$16.4M	15%	$0.67	$0.57	$0.69	Reduced miss
	Q4*	$32.6M	47%	$0.38	$0.20	$0.61	Reduced miss
2011	Q4	$11.0M	7%	$0.98	$0.91	$0.91	Helped beat
2012	Q4	$27.0M	12%	$1.39	$1.23	$0.93	--
2013	Q2*	$65.0M	25%	$1.53	$1.15	$1.16	Avoid miss
	Q4	$16.0M	7%	$1.24	$1.15	$1.18	Avoid miss
2014	Q4	$20.0M	7%	$1.71	$1.59	$1.63	Avoid miss

*Indicates change in UHS's reserve estimation methodology

Moreover, in the thirteen quarters from Q1 2010 through Q4 2014 during which UHS did not reduce its professional and general liability reserve, UHS missed analyst estimates only twice, and one of those misses ties in directly to our concern with the Audit Committee's oversight of UHS's accounting practices: in Q3 2014, UHS disclosed a larger than anticipated $65 million settlement related to the

Garden City Employees' Retirement System v. PSI class action lawsuit. UHS first disclosed that a reserve had been established in connection with Garden City in 2011, but did not disclose its estimates for the likely settlement amount and insurance recovery until Q2 2014, when it identified these amounts as $25 million and $20 million respectively. UHS further disclosed that, "Although we cannot predict the outcome, it is possible the commercial insurance recoveries may not be sufficient to cover the ultimate disposition of this matter (including related legal fees) which would make us liable for a potentially material excess amount."[ix] As indicated in Table 3 below, it appears that UHS substantially underestimated the size of the settlement while overestimating the amount it anticipated recovering from its commercial insurance policies, which led to the $44 million pre-tax charge in the third quarter.

Table 3. Overly optimistic estimates by UHS management led to the company's $44M charge

	UHS estimate	Actual	Difference
Settlement	$25M	$65M	$40M (under estimated)
Insurance recovery	$20M	$16M	$4M (over estimated)
Out of pocket	$5M	$49M	$44M (under estimated)

This combination of facts - a significant reduction in reserves, a persistent contemporaneous effect of these reserve reductions on reported earnings vs. analyst estimates, and a dramatic failure to accurately estimate the size and insurance recovery from the *Garden City* settlement - strongly suggests to us that UHS's decision to alter its reserve methodology was mistaken, and that the Audit Committee should promptly review the relevant policies and practices to ensure that the future risks to long-term shareholders - including litigation and regulatory enforcement risks- are minimized.

Board Reform for UHS

In the year since our last communication, it has become evident that the risks to long-term UHS shareholders from the lack of effective oversight of regulatory compliance are if anything greater than we feared. Moreover, it appears that the Audit Committee has approved reserve accounting practices that led directly to a significant and surprising reduction in reported earnings for 2014 and that appear to have boosted reported earnings in several other reporting periods. As we have repeatedly noted, the tasks of regulatory compliance oversight and oversight of accounting and financial reporting controls and practices are each in themselves complex and if not executed effectively, creates significant risks for long-term shareholders. We urge you to step forward at this year's annual meeting and provide shareholders with a thorough explanation of the board and the Audit Committee's past decisions and current structure as they are relevant to the compliance and accounting concerns we have raised.

Sincerely,

Dieter Waizenegger, Executive Director

[i] HCA 2014 10K - p. 67, LifePoint 2014 10K – p. 88, CHS 2014 10K p. 84,

[ii] UHS Form 10-K for the year ending December 31, 2014. Filed February 26, 2015. p.34.

[iii] "Center for troubled girls will close, cites decision by DCFS."*Chicago Tribune*. January 28, 2015 - http://www.chicagotribune.com/news/watchdog/rtc/chi-youth-treatment-rock-river-20150128-story.html#page=1

[iv] UHS Form 10-K for the year ending December 31, 2010. Filed February 28, 2011. p.140 - https://www.sec.gov/Archives/edgar/data/352915/000119312511050142/d10k.htm

[v] UHS Form 10-Q for the quarter ending June 30, 2013. pp.11-12 - https://www.sec.gov/Archives/edgar/data/352915/000119312513325377/d545907d10q.htm

[vi] UHS Form 10-K for the year ending December 31, 2010. Filed February 28, 2011. p.128

[vii] UHS Form 10-K for the year ending December 31, 2013. Filed February 27, 2014. p.1 - https://www.sec.gov/Archives/edgar/data/352915/000119312514073337/d649956d10k.htm

[viii] "Fast Facts on U.S. Hospitals." The American Hospital Association. Retrieved October 24, 2014 - http://www.aha.org/research/rc/stat-studies/fast-facts.shtml

[ix] UHS Form 10-Q for the quarter ending June 30, 2014. Filed August 8, 2014. p.56

Appendix

Table 1. UHS's professional and general liability self-insurance reserves accounting ($000)[ix]

	General and Professional Liability	% of total assets
Balance at January 1, 2005	**172,534**	**5.7%**
Balance at January 1, 2006	**216,459**	**7.6%**
Balance at January 1, 2007	**244,796**	**7.6%**
Plus: accrued insurance expense, net of commercial premiums paid	67,177	
Less: Reduction in reserves	-18,000	
Less: Payments made in settlement of self-insured claims	-37,960	
Balance at January 1, 2008	**256,013**	**7.1%**
Plus: accrued insurance expense, net of commercial premiums paid	56,904	
Less: Reduction in reserves	0	
Less: Payments made in settlement of self-insured claims	-41,807	
Balance at January 1, 2009	**271,110**	**7.3%**
Plus: accrued insurance expense, net of commercial premiums paid	57,963	
Less: Reduction in reserves	-23,000	
Less: Payments made in settlement of self-insured claims	-40,465	
Balance at January 1, 2010	**265,608**	**6.7%**
Plus: accrued insurance expense, net of commercial premiums paid	53,742	
Less: Reduction in reserves	-49,000	
Less: Payments made in settlement of self-insured claims	-31,713	
Plus: Liabilities assumed in the acquisition of PSI	50,800	
Balance at January 1, 2011	**289,437**	**3.8%**
Plus: Accrued insurance expense, net of commercial premiums paid	61,865	
Less: Reduction in reserves	-11,000	
Less: Payments made in settlement of self-insured claims	-43,786	
Plus: Liabilities assumed in the acquisition of PSI	-4,467	
Balance at January 1, 2012	**292,049**	**3.8%**
Plus: Accrued insurance expense, net of commercial premiums paid	56,152	
Less: Reduction in reserves	-27,000	
Less: Payments made in settlement of self-insured claims	-42,602	
Balance at January 1, 2013	**278,599**	**3.4%**
Plus: Accrued insurance expense, net of commercial premiums paid	45,818	
Less: Reduction in reserves	-81,000	
Less: Payments made in settlement of self-insured claims	-37,127	
Balance at December 31, 2013	**206,290**	**2.5%**
Balance at January 1, 2014	**206,290**	**2.5%**
Plus: Accrued insurance expense, net of commercial premiums paid	22,601	
Less: Payments made in settlement of self-insured claims	-35,987	
Balance at December 31, 2014	192,904	**2.1%**