

NATIONAL HEALTHCARE CORP  
Form 10-Q  
May 09, 2011

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

FORM 10-Q

S QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2011

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001 13489

(Exact name of registrant as specified in its Charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

52 2057472  
(I.R.S. Employer  
Identification No.)

100 E. Vine Street  
Murfreesboro, TN

37130  
(Address of principal executive offices)  
(Zip Code)

(615) 890 2020  
Registrant's telephone number, including area code

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 S  
No. £

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 period that the registrant was required to submit and post such files).

Yes  No

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

Large Accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a  
smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as is defined in Rule 12b-2 of the Exchange Act). Yes  No

13,831,605 shares of common stock of the registrant were outstanding as of May 9, 2011

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****NATIONAL HEALTHCARE CORPORATION****Interim Condensed Consolidated Statements of Income***(Unaudited)**(in thousands, except share and per share amounts)*

	Three Months Ended	
	2011	March 31 2010
<b>REVENUES:</b>		
Net patient revenues	\$ 177,553	\$ 157,961
Other revenues	15,395	14,076
Net revenues	192,948	172,037
<b>COSTS AND EXPENSES:</b>		
Salaries, wages and benefits	108,762	96,076
Other operating	41,389	49,003
Rent	9,865	8,178
Depreciation and amortization	6,962	6,427
Interest	89	114
Total costs and expenses	167,067	159,798
Income Before Non-Operating Income	25,881	12,239
Non-Operating Income	4,561	4,575
Income Before Income Taxes	30,442	16,814
Income Tax Provision	(11,718)	(6,407)
Net Income	18,724	10,407
Dividends to preferred stockholders	(2,168)	(2,168)

Net income available to common stockholders	\$	16,556	\$	8,239
Earnings Per Common Share:				
Basic	\$	1.21	\$	.60
Diluted	\$	1.15	\$	.60
Weighted Average Common Shares Outstanding:				
Basic		13,680,135		13,721,570
Diluted		16,327,236		13,725,201

*The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.*

**NATIONAL HEALTHCARE CORPORATION****Interim Condensed Consolidated Balance Sheets***(in thousands)*

	March 31, 2011	December 31,
		2010
	<i>(unaudited)</i>	
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 33,504	\$ 28,478
Restricted cash and cash equivalents	59,619	51,992
Marketable securities	90,881	85,116
Restricted marketable securities	69,504	70,877
Accounts receivable, less allowance for doubtful accounts of \$3,724 and \$3,942, respectively	68,242	76,559
Inventories	7,699	7,853
Prepaid expenses and other assets	2,970	1,251
Total current assets	332,419	322,126
Property and Equipment:		
Property and equipment, at cost	646,312	640,150
Accumulated depreciation and amortization	(211,025)	(203,758)
Net property and equipment	435,287	436,392
Other Assets:		
Deposits	455	302
Goodwill	20,320	20,320
Notes receivable	23,319	23,671
Deferred income taxes	12,478	12,000
Investments in limited liability companies	15,462	14,204
Total other assets	72,034	70,497
Total assets	\$ 839,740	\$ 829,015

*The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.*

*The interim condensed consolidated balance sheet at December 31, 2010 is taken from the audited consolidated financial statements at that date.*

**NATIONAL HEALTHCARE CORPORATION****Interim Condensed Consolidated Balance Sheets***(in thousands, except share and per share amounts)*

	March 31, 2011	December 31, 2010
	<i>(unaudited)</i>	
<b>Liabilities and Stockholders Equity</b>		
Current Liabilities:		
Trade accounts payable	\$ 11,099	\$ 10,947
Accrued payroll	35,375	52,055
Amounts due to third party payors	16,921	17,667
Accrued risk reserves	98,913	105,059
Deferred income taxes	16,704	14,186
Other current liabilities	23,231	17,895
Dividends payable	6,058	5,997
Total current liabilities	208,301	223,806
Long-Term Debt	10,000	10,000
Other Noncurrent Liabilities	18,896	18,861
Deferred Lease Credits	909	1,212
Deferred Revenue	17,116	13,990
Commitments, Contingencies and Guarantees		
Stockholders Equity:		
Series A Convertible Preferred Stock; \$.01 par value; 25,000,000 shares authorized; 10,840,140 and 10,840,608 shares, respectively, issued and outstanding; stated at liquidation of \$15.75 per share	170,541	170,548
Common stock, \$.01 par value; 30,000,000 shares authorized; 13,804,505 and 13,637,258 shares, respectively, issued and outstanding	138	136
Capital in excess of par value	135,308	128,061
Retained earnings	238,805	226,114

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Unrealized gains on marketable securities, net of taxes		39,726		36,287
Total stockholders equity		584,518		561,146
Total liabilities and stockholders equity	\$	839,740	\$	829,015

*The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.*

*The interim condensed consolidated balance sheet at December 31, 2010 is taken from the audited consolidated financial statements at that date.*



## NATIONAL HEALTHCARE CORPORATION

## Interim Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended	
	March 31	
	2011	2010
	<i>(in thousands)</i>	
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 18,724	\$ 10,407
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,962	6,427
Provision for doubtful accounts receivable	503	507
Equity in earnings of unconsolidated investments	(2,081)	(2,258)
Distributions from unconsolidated investments	823	1,024
Gains on sale of restricted marketable securities	(98)	
Deferred income taxes	(165)	(950)
Stock-based compensation	984	24
Changes in operating assets and liabilities:		
Restricted cash and cash equivalents	(5,584)	(5,407)
Accounts receivable	7,814	(6,293)
Income tax receivable		3,470
Inventories	154	(248)
Prepaid expenses and other assets	(1,719)	(1,605)
Trade accounts payable	152	1,077
Accrued payroll	(16,680)	(15,626)
Amounts due to third party payors	(746)	903
Other current liabilities and accrued risk reserves	(810)	3,331
Entrance fee deposits	(102)	(201)
Other noncurrent liabilities	35	506
Deferred income	3,228	3,299
Net cash provided by (used in) operating activities	11,394	(1,613)
<b>Cash Flows From Investing Activities:</b>		
Additions to and acquisitions of property and equipment	(6,160)	(5,001)
Collections of notes receivable	352	548
Change in restricted cash and cash equivalents	(2,043)	46,826
Purchase of restricted marketable securities	(12,220)	(52,699)

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Sale of restricted marketable securities	13,570	5,875
Net cash used in investing activities	(6,501)	(4,451)
<b>Cash Flows From Financing Activities:</b>		
Tax benefit from stock-based compensation	305	13
Dividends paid to preferred stockholders	(2,168)	(2,168)
Dividends paid to common stockholders	(3,804)	(3,561)
Issuance of common shares	5,953	662
Change in deposits	(153)	(92)
Other		(23)
Net cash provided by (used in) financing activities	133	(5,169)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>5,026</b>	<b>(11,233)</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>28,478</b>	<b>39,022</b>
<b>Cash and Cash Equivalents, End of Period</b>	<b>\$ 33,504</b>	<b>\$ 27,789</b>

*The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.*

## NATIONAL HEALTHCARE CORPORATION

## Interim Condensed Consolidated Statements of Stockholders Equity

*(in thousands, except share and per share amounts)**(unaudited)*

	Preferred Stock		Common Stock		Capital in	Unrealized		Total Stockholders Equity
	Shares	Amount	Shares	Amount	Excess of Par Value	Retained Earnings	Gains on Marketable Securities	
Balance at December 31, 2009	10,841,062	\$ 170,555	13,717,701	\$ 137	\$ 130,867	\$ 197,140	\$ 27,080	\$ 525,779
Net income						10,407		10,407
Unrealized gains on securities (net of tax of \$1,319)							2,099	2,099
Total comprehensive income								12,506
Stock option compensation					24			24
Tax benefit from exercise of stock options					13			13
Shares sold - options exercised			19,978		662			662
Dividends declared						(2,168)		(2,168)

to preferred stockholders (\$0.20 per share)										
Dividends declared to common stockholders (\$0.26 per share)							(3,572)			(3,572)
Balance at March 31, 2010	10,841,062	\$ 170,555	13,737,679	\$	137	\$ 131,566	\$ 201,807	\$	29,179	\$ 533,244
Balance at December 31, 2010	10,840,608	\$ 170,548	13,637,258	\$	136	\$ 128,061	\$ 226,114	\$	36,287	\$ 561,146
Net income							18,724			18,724
Unrealized gains on securities (net of tax of \$2,205)									3,439	3,439
Total comprehensive income										22,163
Stock option compensation							984			984
Tax benefit from exercise of stock options										305
Shares sold options exercised			167,134		2	5,951				5,953
	(468)	(7)	113							7

Shares issued in conversion of preferred stock to common stock									
Dividends declared to preferred stockholders (\$0.20 per share)						(2,168)			(2,168)
Dividends declared to common stockholders (\$0.28 per share)						(3,865)			(3,865)
Balance at March 31, 2011	10,840,140	\$ 170,541	13,804,505	\$ 138	\$ 135,308	\$ 238,805	\$ 39,726	\$	584,518

*The accompanying notes to interim condensed consolidated financial statements are an integral part of these consolidated statements.*

NATIONAL HEALTHCARE CORPORATION

March 31, 2011

(unaudited)

**Note 1 Consolidated Financial Statements**

The unaudited condensed consolidated financial statements to which these notes are attached include all normal, recurring adjustments which are necessary to fairly present the financial position, results of operations and cash flows of National HealthCare Corporation ("NHC" or the "Company"). We assume that users of these interim financial statements have read or have access to the audited December 31, 2010 consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies, may be determined in that context. Accordingly, footnotes and other disclosures which would substantially duplicate the disclosure contained in our most recent annual report to stockholders have been omitted. This interim financial information is not necessarily indicative of the results that may be expected for a full year for a variety of reasons. Our audited December 31, 2010 consolidated financial statements are available at our web site: [www.nhccare.com](http://www.nhccare.com).

**Note 2 Other Revenues**

Other revenues are outlined in the table below. Revenues from insurance services include premiums for workers compensation, health insurance, and professional liability insurance policies that our wholly-owned limited purpose insurance subsidiaries have written for certain long-term health care centers to which we provide management or accounting services. Revenues from management and accounting services include management and accounting fees provided to managed and other long-term health care centers. Revenues from rental income include health care real estate properties owned by use and leased to third party operators. "Other" revenues include miscellaneous health care related earnings.

Other revenues include the following:

Three Months Ended

	March 31	
<i>(in thousands)</i>	2011	2010
Insurance services	\$ 4,084	\$ 4,389
Management and accounting services fees	5,892	6,207
Rental income	4,859	3,049
Other	560	431
	\$ 15,395	\$ 14,076

#### *Management Fees from National*

Certain of our affiliates manage five long-term care centers owned by National Health Corporation ("National"). During the three months ended March 31, 2011 and 2010, we recognized management fees and interest on management fees of \$906,000 and \$1,446,000, respectively, from these centers.

The unpaid fees from the five centers owned by National, because the amount collectable could not be reasonably determined when the management services were provided, and because we cannot estimate the timing or amount of expected future collections, will be recognized as revenues only when fixed or determinable and collectibility of these fees can be reasonably assured. Under the terms of our management agreement with National, the payment of these fees to us may be subordinated to other expenditures of the five long-term care centers. We continue to manage these centers so that we may be able to collect our fees in the future and because the incremental savings from discontinuing services to a center may be small compared to the potential benefit. We may receive payment for the unrecognized management fees in whole or in part in the future only if cash flows from the operating and investing activities of the five centers or the proceeds from the sale of the centers are sufficient to pay the fees. There can be no assurance that such future improved cash flows will occur.

NATIONAL HEALTHCARE CORPORATION

March 31, 2011

(unaudited)

*Management Fees from Other Nursing Centers*

We continue to manage eight long-term care centers (excluding the five National centers) for third-party owners where the management fees are recognized only when realized. During the three months ended March 31, 2011 and 2010, we recognized \$400,000 and \$505,000, respectively, of management fees and interest from these eight long-term care centers.

The unpaid fees from these eight centers, because of insufficient historical collections and the lack of expected future collections, are recognized only when realized. Under the terms of the management agreements, the payment of these fees to us may be subordinated to other expenditures of each of the long-term care centers. Our affiliates continue to manage these centers so that we may be able to collect our fees in the future and because the incremental savings from discontinuing services to a center may be small compared to the potential benefit. We may receive payment for the unrecognized management fees in whole or in part in the future only if cash flows from operating and investing activities of the centers or the proceeds from the sale of the centers are sufficient to pay the fees. There can be no assurance that such future improved cash flows will occur.

*Rental Income*

The health care properties currently owned and leased to third party operators include nine skilled nursing facilities and four assisted living communities. Effective January 1, 2011, we renewed the rental agreements with the third party operators. The rental agreements continue for a five year period ending on December 31, 2015.

**Note 3 - Non-Operating Income**



Non-operating income is outlined in the table below. Non-operating income includes equity in earnings of unconsolidated investments, dividends and other realized gains and losses on securities, and interest income. Our most significant equity method investment is a 57.4% non-controlling ownership interest in Caris HealthCare L.P., a business that specializes in hospice care services.

	Three Months Ended March 31	
<i>(in thousands)</i>	2011	2010
Equity in earnings of unconsolidated investments	\$ 2,081	\$ 2,258
Dividends and other net realized gains and losses on sales of securities	1,270	1,140
Interest income	1,210	1,177
	\$ 4,561	\$ 4,575

#### **Note 4 Other Operating Expenses**

Other operating expenses include the costs of care and services that we provide to the residents of our facilities and the costs of maintaining our facilities. Our primary patient care costs include drugs, medical supplies, purchased professional services, food, professional insurance and licensing fees. The primary facility costs include utilities and property insurance. For the three months ended March 31, 2011, the decrease in other operating expense is primarily due to the favorable results within our accrued risk reserves of approximately \$9,236,000 compared to the quarter a year ago.

## NATIONAL HEALTHCARE CORPORATION

March 31, 2011

(unaudited)

**Note 5 Earnings per Share**

Basic net income per share is computed based on the weighted average number of common shares outstanding for each period presented. Diluted net income per share reflects the potential dilution that would have occurred if securities to issue common stock were exercised, converted, or resulted in the issuance of common stock that would have then shared in our earnings.

The following table summarizes the earnings and the weighted average number of common shares used in the calculation of basic and diluted earnings per share.

<i>(in thousands, except for share and per share amounts)</i>	Three Months Ended March 31	
	2011	2010
Basic:		
Weighted average common shares outstanding	13,680,135	13,721,570
Net income	\$ 18,724	\$ 10,407
Dividends to preferred stockholders	2,168	2,168
Net income available to common stockholders	16,556	8,239
Earnings per common share, basic	\$ 1.21	\$ .60
Diluted:		
Weighted average common shares outstanding	13,680,135	13,721,570
Dilutive effect of stock options	14,559	3,631
Dilutive effect of restricted stock	8,769	
Convertible preferred stock	2,623,773	

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Assumed average common shares outstanding	16,327,236	13,725,201
Net income available to common stockholders	\$ 16,556	\$ 8,239
Add dilutive preferred stock dividends for effect of assumed conversion of preferred stock	2,168	
Net income for diluted earnings per common share	18,724	8,239
Earnings per common share, diluted	\$ 1.15	\$ .60

In the above table, 1,394,251 and 356,791 options to purchase our common stock have been excluded for 2011 and 2010, respectively, and 2,623,971 of potential common shares issuable upon the conversion of the preferred stock have been excluded for 2010 due to their anti-dilutive impact.

**Note 6 - Investments in Marketable Securities**

Our investments in marketable securities include available for sale securities. Realized gains and losses from securities sales are determined on the specific identification of the securities.

## NATIONAL HEALTHCARE CORPORATION

March 31, 2011

(unaudited)

Marketable securities and restricted marketable securities consist of the following:

<i>(in thousands)</i>	March 31, 2011		December 31, 2010	
	Amortized	Fair	Amortized	Fair
	Cost	Value	Cost	Value
Investments available for sale:				
Marketable equity securities	\$ 29,604	\$ 90,881	\$ 29,604	\$ 85,116
Restricted investments available for sale:				
Corporate debt securities	29,084	29,439	28,683	29,182
Commercial mortgage-backed securities	28,473	29,068	26,282	26,866
U.S. Treasury securities	4,392	4,302	8,192	8,030
U.S. government sponsored enterprise securities	—	—	2,340	2,423
State and municipal securities	6,647	6,695	4,348	4,376
	\$ 98,200	\$ 160,385	\$ 99,449	\$ 155,993

Included in the available for sale marketable equity securities are the following:

*(in thousands, except share amounts)*

	March 31, 2011			December 31, 2010		
	Shares	Cost	Fair Value	Shares	Cost	Fair Value

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NHI Common Stock	1,630,642	\$ 24,734	\$ 78,140	1,630,642	\$ 24,734	\$ 73,412
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The amortized cost and estimated fair value of debt securities classified as available for sale, by contractual maturity, are as follows:

<i>(in thousands)</i>	March 31, 2011		December 31, 2010	
	Cost	Fair Value	Cost	Fair Value
Maturities:				
Within 1 year	\$ 3,921	\$ 3,929	\$ 3,551	\$ 3,562
1 to 5 years	47,705	48,591	46,461	47,340
6 to 10 years	16,045	16,057	18,313	18,454
Over 10 years	925	927	1,520	1,521
	\$ 68,596	\$ 69,504	\$ 69,845	\$ 70,877

Gross unrealized gains related to available for sale securities are \$62,490,000 and \$56,911,000 as of March 31, 2011 and December 31, 2010, respectively. Gross unrealized losses related to available for sale securities were \$306,000 and \$367,000 as of March 31, 2011 and December 31, 2010, respectively.

Proceeds from the sale of investments in marketable securities during the three months ended March 31, 2011 and March 31, 2010 were \$13,570,000 and \$5,875,000, respectively. Gross investment gains of \$98,000 and \$38,000 were realized on these sales during the three months ended March 31, 2011 and March 31, 2010, respectively.

NATIONAL HEALTHCARE CORPORATION

March 31, 2011

(unaudited)

**Note 7 - Fair Value Measurements**

The carrying amounts of cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to their short-term nature. The estimated fair value of notes receivable approximates the carrying value based principally on their underlying interest rates and terms, maturities, collateral and credit status of the receivables. Our long-term debt approximates fair value due to variable interest rates. At March 31, 2011 and December 31, 2010, there were no material differences between the carrying amounts and fair values of NHC's financial instruments stated above.

The accounting standard for fair value measurements provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. This accounting standard establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs that may be used to measure fair value:

*Level 1* The valuation is based on quoted prices in active markets for identical instruments.

*Level 2* The valuation is based on observable inputs such as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

*Level 3* The valuation is based on unobservable inputs that are supported by minimal or no market activity and that are significant to the fair value of the instrument. Level 3 valuations are typically performed using pricing models, discounted cash flow methodologies, or similar techniques that incorporate management's own estimates of assumptions that market participants would use in pricing the instrument, or valuations that require significant management judgment or estimation.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The Company determines fair value for marketable securities with Level 1 inputs through quoted market prices. The Company determines fair value for marketable securities with Level 2 inputs through broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. Our Level 2 marketable securities have been initially valued at the transaction price and subsequently valued, at the end of each month, typically utilizing third party pricing services or other market observable data. The pricing services utilize industry standard valuation models, including both income and market based approaches and observable market inputs to determine value. These observable market inputs include reportable trades, benchmark yields, credit spreads, broker/dealer quotes, bids, offers, and other industry and economic events. We did not have any significant transfers of assets between Level 1 and Level 2 of the fair value measurement hierarchy during the three months ended March 31, 2011.

## NATIONAL HEALTHCARE CORPORATION

March 31, 2011

(unaudited)

The following table summarizes fair value measurements by level at March 31, 2011 and December 31, 2010 for assets and liabilities measured at fair value on a recurring basis (*in thousands*):

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2011				
Cash and cash equivalents	\$ 33,504	\$ 33,504	\$	\$
Restricted cash and cash equivalents	59,619	59,619		
Marketable equity securities	90,881	90,881		
Corporate debt securities	29,439		29,439	
Commercial mortgage-backed securities	29,068		29,068	
U.S. Treasury securities	4,302	4,302		
State and municipal securities	6,695		6,695	
Total financial assets	\$ 253,508	\$ 188,306	\$ 65,202	\$

December 31, 2010	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets For Identical Assets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)



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(Level 1)

Cash and cash equivalents	\$	28,478	\$	28,478	\$	\$
Restricted cash and cash equivalents		51,992		51,992		
Marketable equity securities		85,116		85,116		
Corporate debt securities		29,182				29,182
Commercial mortgage-backed securities		26,866				26,866
U.S. Treasury securities		8,030		8,030		
U.S. government sponsored enterprise securities		2,423				2,423
State and municipal securities		4,376				4,376
Total financial assets	\$	236,463	\$	173,616	\$	62,847 \$

## NATIONAL HEALTHCARE CORPORATION

March 31, 2011

(unaudited)

**Note 8 - Long-Term Debt and Commitments**

Long-term debt consists of the following:

<i>(dollars in thousands)</i>	Weighted	Maturities	Long-Term Debt	
	Average		3/31/11	12/31/10
	Interest Rate			
Revolving Credit Facility, interest payable monthly	Variable, 1.25%	2011	\$	\$
Unsecured term note payable to National, interest payable quarterly, principal payable at maturity	Variable, 2.8%	2018	10,000 10,000	10,000 10,000
Less current portion			\$ 10,000	\$ 10,000

**Note 9 - \$75,000,000 Revolving Credit Facility**

Effective October 26, 2010, we extended the maturity of our Credit Agreement (the "Credit Agreement") with Bank of America, N.A., as lender (the "Lender"). The Credit Agreement provides for a \$75,000,000 revolving credit facility (the "Credit Facility"), of which up to \$5,000,000 may be utilized for letters of credit.

Borrowings bear interest at either (i) the Eurodollar rate plus 1.00% or (ii) the prime rate. Letter of credit fees are equal to 1.00% times the maximum amount available to be drawn under outstanding letters of credit. The rates and fees are unchanged from those in effect prior to the extension.

Commitment fees are payable on the daily unused portion of the Credit Facility at a rate of twenty (20) basis points per annum. NHC is permitted to prepay the loans outstanding under the Credit Facility at any time, without penalty.

The Credit Facility matures on October 25, 2011. Between 90 and 120 days prior to the maturity date, NHC may request the extension of the maturity date. If the Lender elects to consent to such extension, subject to certain conditions, the maturity date will be extended to the date which is 364 days after the then maturity date.

NHC's obligations under the Credit Agreement are guaranteed by certain NHC subsidiaries and are secured by pledges by NHC and the guarantors of (i) 100% of the equity interests of domestic subsidiaries and (ii) up to 65% of the voting equity interests and 100% of the non-voting equity interests of foreign subsidiaries, in each case, held by NHC or the guarantors.

The Credit Agreement contains customary representations and warranties, and covenants, including covenants that restrict, among other things, asset dispositions, mergers and acquisitions, dividends, restricted payments, debt, liens, investments and affiliate transactions. The Credit Agreement contains customary events of default.

The Credit Facility is available for general corporate purposes, including working capital and acquisitions.

NATIONAL HEALTHCARE CORPORATION

March 31, 2011

(unaudited)

**Note 10 Stock-Based Compensation**

NHC recognizes stock-based compensation for all stock options and restricted stock granted over the requisite service period using the fair value for these grants as estimated at the date of grant either using the Black-Scholes pricing model for stock options or the quoted market price for restricted stock.

*The 2005 and 2010 Stock-Based Compensation Plans*

The Compensation Committee of the Board of Directors ( the Committee ) has the authority to select the participants to be granted options; to designate whether the option granted is an incentive stock option ( ISO ), a non qualified option, or a stock appreciation right; to establish the number of shares of common stock that may be issued upon exercise of the option; to establish the vesting provision for any award; and to establish the term any award may be outstanding.

The exercise price of any ISO s granted will not be less than 100% of the fair market value of the shares of common stock on the date granted and the term of an ISO may not be any more than ten years. The exercise price of any non qualified options granted will not be less than 100% of the fair market value of the shares of common stock on the date granted unless so determined by the Committee.

In May 2005, our stockholders approved the 2005 Stock Option, Employee Stock Purchase, Physician Stock Purchase and Stock Appreciation Rights Plan ( the 2005 Plan ) pursuant to which 1,200,000 shares of our common stock were available to grant as stock-based payments to key employees, directors, and non-employee consultants. In March 2011, the Company granted stock options to purchase 756,585 shares of our common stock in accordance with the 2005 Plan. These particular stock options become vested and exercisable thirty days prior to the expiration date of the options, which is five years after the date of grant. At March 31, 2011, no shares were available for future grants under the 2005 Plan.

In May 2010, our stockholders approved the 2010 Omnibus Equity Incentive Plan ( the 2010 Plan ) pursuant to which 1,200,000 shares of our common stock were available to grant as stock-based payments to key employees, directors, and non-employee consultants. In March 2011, the Company granted stock options to purchase 443,417 shares of our common stock in accordance with the 2010 Plan. These particular stock options become vested and exercisable thirty

days prior to the expiration date of the options, which is five years after the date of the grant. At March 31, 2011, 579,952 shares were available for future grants under the 2010 Plan.

Compensation expense is recognized only for the awards that ultimately vest. Stock-based compensation totaled \$984,000 and \$24,000 for the three months ended March 31, 2011 and 2010, respectively. The expense for the 2011 period increased \$771,000 due to the Company choosing to accelerate the vesting date of options to purchase 158,000 shares of stock that were granted in June 2010. The options had an original vesting date in June 2015. At March 31, 2011, we had \$9,472,000 of unrecognized compensation cost related to unvested stock-based compensation awards, which consisted of \$8,624,000 for stock options and \$848,000 for restricted stock. This expense will be recognized over the remaining weighted average vesting period, which is approximately 4.9 years for stock options and 2.5 years for restricted stock. Stock-based compensation is included in Salaries, wages and benefits in the Consolidated Statements of Income.

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*Stock Options*

The following table summarizes the assumptions used to value the options granted in the periods shows.

	2011	2010
Risk-free interest rate	2.07%	1.88%
Expected volatility	23.59%	25.30%
Expected life, in years	4.9 years	4.5 years
Expected dividend yield	3.65%	3.55%
Expected forfeiture rate	0.00%	0.00%

The following table summarizes our outstanding stock options for the three months ended March 31, 2011 and for the year ended December 31, 2010.

	Number of	Weighted	Aggregate
	Shares	Average	Intrinsic
		Exercise Price	Value
Options outstanding at December 31, 2009	385,305	\$ 44.78	
Options granted	180,485	35.55	
Options exercised	(72,149)	36.69	
Options cancelled or expired	(21,314)	32.01	
Options outstanding at December 31, 2010	472,327	43.07	
Options granted	1,218,615	46.69	
Options exercised	(167,134)	35.62	

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Options cancelled or expired	-		-		
Options outstanding at March 31, 2011	1,523,808	\$	46.78	\$	765,000
Options exercisable at March 31, 2011	305,177	\$	47.15	\$	765,000

Options		Weighted Average	
Outstanding		Weighted Average	Remaining Contractual
March 31, 2011	Exercise Prices	Exercise Price	Life in Years
129,557	\$37.70 - \$44.25	\$40.58	1.8
1,394,251	\$46.44 - \$52.50	47.35	4.4
1,523,808		\$46.78	4.2

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*Restricted Stock*

The following table summarizes our restricted stock activity for the three months ended March 31, 2011 and for the year ended December 31, 2010.

	Number of Shares	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Unvested restricted shares at December 31, 2009		\$	
Award shares granted	30,000	34.46	
Award shares vested			
Unvested restricted shares at December 31, 2010	30,000	34.46	
Award shares granted			
Award shares vested			
Unvested restricted shares at March 31, 2011	30,000	\$ 34.46	\$ 361,000

The weighted average remaining contractual life of restricted stock at March 31, 2011 is 2.1 years.

**Note 11 Accounting for Uncertainty in Income Taxes**

NHC continually evaluates for uncertain tax positions. Uncertain tax positions may arise where tax laws may allow for alternative interpretations or where the timing of recognition of income is subject to judgment. We believe we have made adequate provision for unrecognized tax benefits related to uncertain tax positions. However, because of uncertainty of interpretation by various tax authorities and the possibility that there are issues that have not been



recognized by management, we cannot guarantee we have accurately estimated our tax liabilities. We believe that our liabilities reflect the anticipated outcome of known uncertain tax positions in conformity with ASC Topic 740, *Income Taxes*. Our liabilities for unrecognized tax benefits are presented in the consolidated balance sheets within Other Noncurrent Liabilities.

At March 31, 2011, we had \$14,633,000 of unrecognized tax benefits, composed of \$9,170,000 of deferred tax assets, \$-0- of deferred tax liabilities, and \$5,463,000 of permanent differences. Accrued interest and penalties of \$4,263,000 relate to unrecognized tax benefits at March 31, 2011. Unrecognized tax benefits of \$5,463,000, net of federal benefit, at March 31, 2011, attributable to permanent differences, would favorably impact our effective tax rate if recognized. Accrued interest and penalties of \$2,050,000 relate to these permanent differences at March 31, 2011. We do not expect to recognize significant increases or decreases in unrecognized tax benefits within twelve months beginning March 31, 2011, except for the effect of decreases related to the lapse of statute of limitations estimated at \$2,450,000, composed of temporary differences of \$-0-, and permanent tax differences of \$2,450,000. Interest and penalties of \$836,000 relate to these permanent difference changes within 12 months beginning March 31, 2011.

Interest and penalties expense related to U.S. federal and state income tax returns are included within income tax expense.

The Company is no longer subject to U.S. federal and state examinations by tax authorities for years before 2007 (with certain state exceptions). Currently, there are no U.S. federal or state returns under examination.

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**Note 12 Guarantees and Contingencies**

*Accrued Risk Reserves*

We are self insured for risks related to health insurance and have wholly-owned limited purpose insurance companies that insure risks related to workers' compensation and general and professional liability insurance claims both for our owned or leased entities and certain of the entities to which we provide management or accounting services. The liability we have recognized for reported claims and estimates for incurred but unreported claims totals \$98,913,000 and \$105,059,000 at March 31, 2011 and December 31, 2010, respectively. This liability is classified as a current liability based on the uncertainty regarding the timing of potential payments. The liability is included in accrued risk reserves in the consolidated balance sheets and is subject to adjustment for actual claims incurred. It is possible that these claims plus unasserted claims could exceed our insurance coverages and our reserves, which could have a material adverse effect on our financial position, results of operations and cash flows.

As a result of the terms of our insurance policies and our use of wholly-owned limited purpose insurance companies, we have retained significant insurance risk with respect to workers' compensation and general and professional liability. We use independent actuaries to estimate our exposures for claims obligations (for both asserted and unasserted claims) related to deductibles and exposures in excess of coverage limits, and we maintain reserves for these obligations. Such estimates are based on many variables including historical and statistical information and other factors.

*Workers' Compensation*

For workers' compensation, we utilize a wholly-owned Tennessee domiciled property/casualty insurance company to write coverage for NHC affiliates and for third-party customers. Policies are written for a duration of twelve months and cover only risks related to workers' compensation losses. All customers are companies which operate in the

long-term care industry. Business is written on a direct basis. Direct business coverage is written for statutory limits and the insurance company's losses in excess of \$1,000,000 per claim are covered by reinsurance.

For these workers' compensation insurance operations, the premium revenues reflected in the consolidated financial statements within "Other Revenues" for the three months ended March 31, 2011 and 2010, respectively, are \$1,302,000 and \$1,299,000. Associated losses and expenses are reflected in the consolidated financial statements as "Other operating costs and expenses".

#### *General and Professional Liability Lawsuits and Insurance*

The long term care industry has experienced significant increases in both the number of personal injury/wrongful death claims and in the severity of awards based upon alleged negligence by nursing facilities and their employees in providing care to residents. As of March 31, 2011, we and/or our managed centers are currently defendants in 25 such claims covering the years 2002 through March 31, 2011.

In 2002, we established and capitalized a wholly-owned licensed liability insurance company. Thus, since 2002, insurance coverage for incidents occurring at all NHC owned providers, and most providers managed by us is provided through this wholly-owned insurance company.

Our coverages for all years include primary policies and excess policies. In 2002, deductibles were eliminated and first dollar coverage was provided through the wholly-owned insurance company, while the excess coverage was provided by a third party insurer.

For 2003-2011, both primary professional liability insurance coverage and excess coverage is provided through our wholly-owned liability insurance company. The primary coverage is in the amount of \$1 million per incident, \$3

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million per location with an annual primary policy aggregate limit of \$19.0 million for 2011, \$17.0 million for 2009 and 2010, \$16.0 million for 2008, \$14.0 million for 2006 and 2007, and \$12.0 million for 2003-2005. The excess coverage is \$7.5 million annual excess in the aggregate applicable to years 2003-2007 and subsequently for \$9.0 million annual excess in the aggregate for years 2008-2011.

For these professional liability insurance operations, the premium revenues reflected in the financials as "Other Revenues" for the three months ended March 31, 2011 and 2010, respectively, are \$1,096,000 and \$1,111,000. Associated losses and expenses including those for self-insurance are included in the consolidated financial statements as "Other operating costs and expenses".

*Other Matters*

On July 24, 2009, the Company received a civil investigative demand from the Tennessee Attorney General's Office, requesting production of documents related to NHC's business relationships with non-profit entities. The Company has responded to the demand and complied as required with the terms of the demand.

**Note 13 New Accounting Pronouncements**

In December 2010, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2010-29, which is included in the Codification under ASC 805, Business Combinations. This update provides guidance on the disclosure of supplemental pro forma information for business combinations. This guidance became effective for our interim and annual reporting periods beginning January 1, 2011. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

Also in December 2010, the FASB issued ASU No. 2010-28, which is included in the Codification under ASC 350, Intangibles Goodwill and Other. This update provides guidance on applying the goodwill impairment test for reporting units with zero or negative carrying amounts. This guidance became effective for our interim and annual

reporting periods beginning January 1, 2011. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

In August 2010, the FASB issued ASU No. 2010-24, which is included in the Codification under ASC 954, Health Care Entities . This update provides clarification to companies in the healthcare industry on the accounting for professional liability and workers compensation insurance. This update states that receivables related to insurance recoveries should not be netted against the related claim liability and such claim liabilities should be determined without considering insurance recoveries. This guidance became effective for our interim and annual reporting periods beginning January 1, 2011. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

## **Item 2.**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations.**

#### Overview

National HealthCare Corporation ( NHC or the Company ) is a leading provider of long-term health care services. We operate or manage, through certain affiliates, 76 long-term health care centers with 9,548 beds in 10 states and provide other services in one additional state. These operations are provided by separately funded and maintained subsidiaries. We provide long-term health care services to patients in a variety of settings including long-term nursing centers, managed care specialty units, sub-acute care units, Alzheimer's care units, hospice programs, homecare programs, assisted living centers and independent living centers. In addition, we provide insurance services, management and accounting services, and lease properties to owners of long-term health care centers.

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Summary of Goals and Areas of Focus

*Earnings* To monitor our earnings, we have developed budgets and management reports to monitor labor, census, and the composition of revenues. Inflationary increases in our costs may cause net earnings from patient services to decline. Further, our patient revenues, approximately 70% of which are paid by government entities, may be reduced because of the efforts by government entities to contain their costs.

*Development and Growth* We are undertaking to expand our long-term care operations while protecting our existing operations and markets. The following table lists our recent or expected construction and purchase activities.

Type of Operation	Description	Size	Location	Placed in Service
Skilled Nursing	New Facility	120 Beds	Bluffton, SC	January 2010
Assisted Living	New Facility	45 Units	Mauldin, SC	March 2010
Homecare	Acquisition	353 ADC	Columbia, Rock Hill, and Summerville, SC	May, 2010
Skilled Nursing	Acquisition	120 Beds	Macon, MO	December, 2010
Skilled Nursing	Acquisition	120 Beds	Osage Beach, MO	December, 2010
Skilled Nursing	Acquisition	120 Beds	Springfield, MO	December, 2010

In the second quarter of 2011, we expect to open a 75-unit assisted living community in Columbia, South Carolina, as well as a 46-unit assisted living addition in Franklin, Tennessee. Also, in 2011, we expect to begin construction on a 90-bed skilled nursing facility in Tullahoma, Tennessee and a 92-bed skilled nursing facility in Hendersonville, Tennessee.

During 2011, we will apply for Certificates of Need for additional beds in our markets and also evaluate the feasibility of expansion into new markets by building private pay health care centers or by the purchase of existing health care centers. We will also evaluate the feasibility of construction of new assisted living facilities in select markets.

*Accrued Risk Reserves* Our accrued professional liability reserves, workers compensation reserves and health insurance reserves totaled \$98,913,000 at March 31, 2011, a 10.7% reduction since March 31, 2010, and are a primary area of management focus. We have set aside restricted cash and cash equivalents and marketable securities to fund substantially all of our professional liability and workers compensation liabilities.

As to exposure for professional liability claims, we have developed for our centers performance certification criteria to measure and bring focus to the patient care issues most likely to produce professional liability exposure, including in house acquired pressure ulcers, significant weight loss and numbers of falls. These programs for certification, which we regularly modify and improve, have produced measurable improvements in reducing these incidents. Our experience is that achieving goals in these patient care areas improves both patient and employee satisfaction.

#### Application of Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and cause our reported net income to vary significantly from period to period.

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Our critical accounting policies that are both important to the portrayal of our financial condition and results and require our most difficult, subjective or complex judgments are as follows:

*Revenue Recognition - Third Party Payors* Approximately 70% of our net patient revenues are derived from Medicare, Medicaid, and other government programs. Amounts earned under these programs are subject to review by the Medicare and Medicaid intermediaries or their agents. In our opinion, adequate provision has been made for any adjustments that may result from these reviews. Any differences between our original estimates of reimbursements and subsequent revisions are reflected in operations in the period in which the revisions are made often due to final determination or the period of payment no longer being subject to audit or review. We have made provisions of approximately \$16,921,000 as of March 31, 2011 for various Medicare and Medicaid current and prior year cost reports and claims reviews.

*Revenue Recognition - Private Pay* - For private pay patients in skilled nursing or assisted living facilities, we bill room and board in advance for the current month with payment being due upon receipt of the statement in the month the services are performed. Charges for ancillary, pharmacy, therapy and other services to private patients are billed in the month following the performance of services; however, all billings are recognized as revenue when the services are performed.

*Revenue Recognition - Subordination of Fees and Uncertain Collections* - We provide management services to certain long-term care facilities and to others we provide accounting and financial services. We generally charge 6% to 7% of net revenues for our management services and a predetermined fixed rate per bed for the accounting and financial services. Our policy is to recognize revenues associated with both management services and accounting and financial services on an accrual basis as the services are provided. However, under the terms of our management contracts, payments for our management services are subject to subordination to other expenditures of the long-term care center being managed. Furthermore, for certain of the third parties with whom we have contracted to provide services and which we have determined, based on insufficient historical collections and the lack of expected future collections, that collection is not reasonably assured, our policy is to recognize income only in the period in which the amounts are realized. We may receive payment for the unpaid and unrecognized management fees in whole or in part in the future only if cash flows from the operating and investing activities of the centers or proceeds from the sale of the centers are sufficient to pay the fees. There can be no assurance that such future cash flows will occur. The realization of such previously unrecognized revenue could cause our reported net income to vary significantly from period to period.



We agree to subordinate our fees to the other expenses of a managed center because we believe we know how to improve the quality of patient services and finances of a long-term care center and because subordinating our fees demonstrates to the owner and employees of the managed center how confident we are of the impact we can have in making the center operations successful. We may continue to provide services to certain managed centers despite not being fully paid currently so that we may be able to collect unpaid fees in the future from improved operating results and because the incremental savings from discontinuing services to a center may be small compared to the potential benefit. Also, we may benefit from providing other ancillary services to the managed center.

*Accrued Risk Reserves* - We are principally self-insured for risks related to employee health insurance, workers compensation and professional and general liability claims. Our accrued risk reserves primarily represent the accrual for self-insured risks associated with employee health insurance, workers compensation and professional and general liability claims. The accrued risk reserves include a liability for reported claims and estimates for incurred but unreported claims. Our policy with respect to a significant portion of our workers compensation and professional and general liability claims is to use an actuary to estimate our exposure for claims obligations (for both asserted and unasserted claims). Our health insurance reserve is based on our known claims incurred and an estimate of incurred but unreported claims determined by our analysis of historical claims paid. We reassess our accrued risk reserves on a quarterly basis.

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Professional liability remains an area of particular concern to us. The entire long term care industry has seen a dramatic increase in personal injury/wrongful death claims based on alleged negligence by nursing homes and their employees in providing care to residents. As of March 31, 2011, we and/or our managed centers are defendants in 25 such claims inclusive of years 2002 through 2011. It remains possible that those pending matters plus potential unasserted claims could exceed our reserves, which could have a material adverse effect on our financial position, results of operations and cash flows. It is also possible that future events could cause us to make significant adjustments or revisions to these reserve estimates and cause our reported net income to vary significantly from period to period.

We maintain insurance coverage for incidents occurring in all providers owned or leased by us, and most providers managed by us. The coverages include both primary policies and excess policies. In all years, settlements, if any, in excess of available insurance policy limits and our own reserves would be expensed by us.

*Credit Losses* - Certain of our accounts receivable from private paying patients and certain of our notes receivable are subject to credit losses. We have attempted to reserve for expected accounts receivable credit losses based on our past experience with similar accounts receivable and believe our reserves to be adequate.

We continually monitor and evaluate the carrying amount of our notes receivable in accordance with ASC Topic 310, *Receivables*. It is possible, however, that the accuracy of our estimation process could be materially impacted as the composition of the receivables changes over time. We continually review and refine our estimation process to make it as reactive to these changes as possible. However, we cannot guarantee that we will be able to accurately estimate credit losses on these balances. It is possible that future events could cause us to make significant adjustments or revisions to these estimates and cause our reported net income to vary significantly from period to period.

*Uncertain Tax Positions* - We continually evaluate for uncertain tax positions. These uncertain positions may arise where tax laws may allow for alternative interpretations or where the timing of recognition of income is subject to judgment. We believe we have adequate provisions for our uncertain tax positions including related penalties and interest. However, because of uncertainty of interpretation by various tax authorities and the possibility that there are issues that have not been recognized by management, we cannot guarantee we have accurately estimated our tax liabilities.

The above listing is not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles, with limited need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. See our audited consolidated financial statements and notes thereto which contain accounting policies and other disclosures required by generally accepted accounting principles.

#### Government Program Financial Changes

Cost containment will continue to be a priority for Federal and State governments for health care services, including the types of services we provide. Government reimbursement programs such as Medicare and Medicaid prescribe, by law, the billing methods and amounts that health care providers may charge and be reimbursed to care for patients covered by these programs. Congress has passed a number of laws that have effected major changes in the Medicare and Medicaid programs. The Balanced Budget Act of 1997 sought to achieve a balanced federal budget by, among other things, reducing federal spending on Medicare and Medicaid to various providers. The Balanced Budget Act of 1997 defined the Medicare Prospective Payment System ("PPS") and this System has subsequently been refined in 1999, 2000, 2005, 2006 and 2010.

*Health Care Reform* In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act ("PPACA") and the Health Care and Education Reconciliation Act of 2010 ("HCERA"), which represents

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significant changes to the current U.S. health care system (collectively the "Acts"). The Acts affect aging services providers, our partners (employees) and our patients and residents in a multitude of ways. We are evaluating the provisions of the Acts and do not expect material effects on our results of operations, liquidity and cash flows in 2011. We anticipate many of the provisions of the Acts may be subject to further clarification and modification through the rule-making process. It is uncertain at this time the effect the modifications will have on our future results of operations or cash flows.

In December 2010, President Obama signed into law the Medicare and Medicaid Extenders Act ( MMEA ). This legislation affects numerous health care providers and makes several important technical corrections to the health reform laws enacted earlier in 2010. An important item provided for in the MMEA legislation is for an immediate and retroactive updated methodology (Resource Utilization Group Version Four, RUG-IV ) for determining Medicare payment rates to skilled nursing centers. The retroactive date goes back to October 1, 2010. Under the health reform law passed in March 2010, Congress imposed a moratorium on implementing the updated methodology until October 1, 2011. The MMEA repeals that provision, and ends the delay in implementing RUG-IV, allowing skilled nursing center rates determined by RUG-IV to be applied as of October 1, 2010.

*Medicare* Effective October 1, 2010, the federal RUG rates had a market basket increase of 2.3%. There was also a negative .6 percentage point forecasting error adjustment, generating a net market basket increase of 1.7%. According to CMS, the transition from RUG-III to RUG-IV would be on a budget neutral basis. CMS states RUG-IV was needed to recalibrate the case-mix system after changes in fiscal year 2006 caused payments to skilled nursing centers to exceed budget neutrality estimates. The effect of the RUG-IV rate changes on our revenues is dependent upon our census and the mix of our patients at the PPS pay rates. The PPS rates had a net market basket decrease of 1.1% in 2009.

For the first three months of 2011, our average Medicare per diem rate increased 18.8% compared to the same period in 2010.

On April 28, 2011, CMS released its fiscal year 2012 proposed notice of rulemaking which discusses two options the agency is considering for purposes of setting the 2012 Medicare payment rates for skilled nursing facilities (SNF's). The first option CMS is proposing is a 2.7% market basket increase that will be reduced by a 1.2% productivity adjustment as a result of the Affordable Care Act, which results in a net increase of 1.5% over fiscal year 2011

payments. The second option CMS is considering would adjust for the unanticipated impact of the change to the new RUG-IV payment system in fiscal year 2011. The proposed second option states that to make the RUG-IV payment system revenue neutral, it would reduce reimbursement rates by approximately 12.8%. After considering the 1.5% market basket increase, the net impact would be an 11.3% rate reduction effective October 1, 2011. The proposed notice has not been finalized and is still in the public comment period. We cannot predict the ultimate impact the proposal will have on our results of operations, liquidity or cash flows in the future.

Effective October 1, 2010, hospice agencies received Medicare payments which represented a 1.8% increase. We estimate the effect of the revenue increase for NHC hospice programs to be approximately \$200,000 annually, or \$50,000 per quarter.

Effective January 2011, home health agencies received Medicare payments which represented a 5.2% decrease. We estimate the effect of the revenue decrease for NHC homecare programs to be approximately \$3,400,000 annually, or \$850,000 per quarter.

*Medicaid* Tennessee annual Medicaid rate increases were implemented effective July 1, 2010. Tennessee Medicaid fully funded the ceiling rate increases for all skilled and intermediate providers. We estimate the resulting increase in revenue from this payment source is approximately \$592,000 per quarter.

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On April 18, 2011, effectively immediately, South Carolina implemented a three percent Medicaid rate reduction. We estimate the resulting decrease in revenue will be approximately \$370,000 per quarter.

For the first three months of 2011, our average Medicaid per diem overall increased by 2.2% compared to the same period in 2010. We face challenges with respect to states' Medicaid payments because many states currently do not cover the total costs incurred in providing care to those patients. States will continue to control Medicaid expenditures but also look for adequate funding sources, including provider assessments. Other provisions could increase state funding for home and community-based services, potentially having an impact on funding for nursing facilities. There is no assurance that the funding for our services will increase or decrease in the future.

Results of Operations

The following table and discussion sets forth items from the interim condensed consolidated statements of income as a percentage of net revenues for the three months ended March 31, 2011 and 2010.

**Percentage of Net Revenues**

	Three Months Ended March 31,	2011	2010
Revenues:			
Net patient revenues		92.0%	91.8%
Other revenues		8.0	8.2
	Net operating revenues	100.0	100.0
Costs and Expenses:			
Salaries, wages and benefits		56.4	55.8

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Other operating	21.5	28.5
Rent	5.1	4.8
Depreciation and amortization	3.6	3.7
Interest	-	0.1
Total costs and expenses	86.6	92.9
Income before non-operating income	13.4	7.1
Non-operating income	2.4	2.7
Income before income taxes	15.8	9.8
Income tax provision	(6.1)	(3.7)
Net Income	9.7	6.1
Dividends to preferred stockholders	(1.1)	(1.3)
Net income available to common stockholders	8.6%	4.8%

*Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010*

The total census at owned and leased centers for the quarter averaged 91.1% compared to an average of 92.4% for the same quarter a year ago.

Results for the three month period ended March 31, 2011 include a 12.2% increase in net revenues and an 81.1% increase in income before taxes compared to the same period in 2010.

Net patient revenues increased \$19,592,000 or 12.4% compared to the same period last year. Medicare, Medicaid and private per diem rates increased 18.8%, 2.2% and 6.0%, respectively, compared to the quarter a year ago. The combination of increased Medicare per diems and a favorable patient mix helped increase Medicare revenues 29.0%

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compared to the quarter a year ago. Our Medicare patient mix increased approximately 70 basis points compared to the quarter a year ago. The newly constructed or acquired businesses (three skilled nursing facilities, one assisted living community, and three homecare programs) helped increase net patient revenues approximately \$6,488,000.

Other revenues increased \$1,319,000 or 9.4% in the three-month 2011 period to \$15,395,000 from \$14,076,000 in the 2010 three-month period. The increase in other revenues is primarily due to an increase in rental income of \$1,810,000. Effective January 1, 2011, we renewed the rental agreements of thirteen of our properties with third party operators. The rental agreements incurred inflationary increases in the base rent amount and continue for a five year period ending on December 31, 2015.

Non-operating income decreased \$14,000 to \$4,561,000 in the three-month 2011 period in comparison to the three-month 2010 period.

Total costs and expenses for the 2011 first quarter compared to the 2010 first quarter increased \$7,269,000 or 4.5% to \$167,067,000 from \$159,798,000. Salaries, wages and benefits, the largest operating costs of this service company, increased \$12,686,000 or 13.2% to \$108,762,000 from \$96,076,000. Other operating expenses decreased \$7,614,000 or 15.5% to \$41,389,000 for the 2011 period compared to \$49,003,000 for the 2010 period. Rent expense increased \$1,687,000 or 20.6% to \$9,865,000. Depreciation and amortization increased to 8.3% to \$6,962,000.

Salaries, wages and benefits as a percentage of net operating revenue was 56.4% and 55.8% for the three months ended March 31, 2011 and 2010, respectively. The increase in salaries, wages and benefits is primarily due to the increased staffing from the opening or acquisition of three skilled nursing facilities, one assisted living community, and three homecare programs (\$3,638,000). We also had increased costs in our existing skilled nursing facilities (\$3,872,000), increased costs for therapist services (\$1,407,000), an increased provision for health insurance claims (\$2,535,000), and inflationary wage increases.

Other operating expense as a percentage of net operating revenue was 21.5% and 28.5% for the three months ended March 31, 2011 and 2010, respectively. The decrease in other operating expenses is primarily due to the favorable results within our accrued risk reserves of approximately \$9,236,000 compared to the quarter a year ago. The



decrease in expense in 2011 is offset by the opening or acquisition of the new operations in the amount of \$2,760,000.

Rent expense for the three months ended March 31, 2011 increased by approximately \$1,687,000 compared to the quarter a year ago. The increase is due to the increased percentage rent paid to National Health Investors, Inc. ( NHI ) in the amount of \$1,666,000. Percentage rent to NHI is equal to 4% of the increase in facility revenues over the 2007 revenues, the base year of the lease agreement.

Depreciation expense increased primarily due to the acquisition and construction of depreciable assets in the last year. The increase in depreciation for the three months ended March 31, 2011 was \$535,000.

The income tax provision for the three months ended March 31, 2011 is \$11,718,000 (an effective income tax rate of 38.5% which is in line with management's expectations). The income tax provision and effective tax rate for the three months ended March 31, 2011 were unfavorably impacted by permanent differences including non-deductible expenses. The income tax provision for the three months ended March 31, 2010 was \$6,407,000 (an effective tax rate of 38.1%). The income tax provision and effective tax rate for the three months ended March 31, 2010 were favorably impacted by permanent differences.

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Liquidity, Capital Resources, and Financial Condition

*Sources and Uses of Funds* - Our primary sources of cash include revenues from the healthcare and senior living facilities we operate, insurance services, management services and accounting services. Our primary uses of cash include salaries, wages and other operating costs of our home office and the facilities we operate, the cost of additions to and acquisitions of real property, rent expenses, and dividend distributions. These sources and uses of cash are reflected in our Consolidated Statements of Cash Flows and are discussed in further detail below. The following is a summary of our sources and uses of cash flows (*dollars in thousands*):

	Three Months Ended		Three Month Change	
	2011	March 31 2010	\$	%
Cash and cash equivalents at beginning of period	\$ 28,478	\$ 39,022	\$ (10,544)	(27)
Cash provided from (used in) operating activities	11,394	(1,613)	13,007	806
Cash used in investing activities	(6,501)	(4,451)	(2,050)	(46)
Cash provided from (used in) financing activities	133	(5,169)	5,302	103
Cash and cash equivalents at end of period	\$ 33,504	\$ 27,789	\$ 5,715	21

*Operating Activities* - Net cash provided by operating activities for the three months ended March 31, 2011 was \$11,394,000 as compared to \$1,613,000 used in operating activities in the same period last year. Cash provided by operating activities consisted of net income of \$18,724,000, adjustments for non-cash items of \$6,928,000, and \$14,258,000 used for working capital and other activities. Working capital and other activities primarily consisted of an increase in restricted cash and cash equivalents of \$5,584,000, a decrease in accounts receivable of \$7,814,000, a

decrease in accrued payroll of \$16,680,000, and an increase in deferred income of \$3,228,000.

The increase in restricted cash and cash equivalents is from NHC healthcare entities paying insurance premiums into NHC insurance companies, which restrict the cash payment. The decrease in accounts receivable is primarily from National paying balances related to interim payroll and benefit services outstanding at December 31, 2010. The decrease in accrued payroll is due to the timing of payroll payments related to incentive compensation. The increase in deferred income is due from the premiums received in our professional liability insurance company which have not yet been earned.

*Investing Activities* - Cash used in investing activities totaled \$6,501,000 and \$4,451,000 for the three months ended March 31, 2011 and 2010, respectively. Cash used for property and equipment additions was \$6,160,000 for the three months ended March 31, 2011 and \$5,001,000 in the comparable period in 2010. Cash provided by net collections of notes receivable was \$352,000 in 2011 compared to \$548,000 in 2010. Purchases and sales of restricted marketable securities resulted in a net use of cash of \$693,000 for the 2011 period.

Costs included in property and equipment additions include \$2,042,000 for the construction-in-progress of the 75-unit assisted living community in Columbia, South Carolina and \$1,113,000 for the 46-unit assisted living addition to our Franklin, Tennessee community. Both of the projects will be completed in the second quarter of 2011.

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*Financing Activities* - Net cash provided by financing activities totaled \$133,000 in the three months ended March 31, 2011 compared to \$5,169,000 net cash used in financing activities in the same period in 2010. Cash used for dividend payments to common and preferred stockholders totaled \$5,972,000. In the prior period, cash used for dividend payments to common and preferred stockholders totaled \$5,729,000. In the current period, \$5,953,000 of cash was provided by the issuance of common stock. Cash of \$662,000 was provided by the issuance of common stock in the same period last year. Tax benefits from exercise of stock options provided cash of \$305,000 in 2011 and \$13,000 for the same period in 2010.

Table of Contractual Cash Obligations

Our contractual cash obligations for periods subsequent to March 31, 2011 are as follows (*in thousands*):

	Total	1 year	1-3 Years	3-5 Years	After 5 Years
Long-term debt – principal	\$ 10,000	\$ –	\$ –	\$ –	\$ 10,000
Long-term debt – interest	1,865	276	553	553	483
Obligations to complete construction	1,695	1,695	–	–	–
Operating leases	362,275	33,700	67,400	67,400	193,775
Total Contractual Cash Obligations	\$ 375,835	\$ 35,671	\$ 67,953	\$ 67,953	\$ 204,258

Other noncurrent liabilities for uncertain tax positions of \$5,463,000, attributable to permanent differences, at March 31, 2011 has not been included in the above table because of the inability to estimate the period in which the tax payment is expected to occur. See Note 11 of the Interim Condensed Consolidated Financial Statements for a discussion on income taxes.

We started paying quarterly dividends on our common shares outstanding in 2004 and our preferred shares outstanding in 2007. We anticipate the continuation of both the common and preferred dividend payments as approved quarterly by the Board of Directors.

Short-term liquidity

Effective October 26, 2010, we extended the maturity of our \$75,000,000 revolving credit agreement to October 25, 2011. We currently do not have any funds drawn against the credit agreement and the amount of \$75,000,000 is available to be drawn for general corporate purposes, including working capital and acquisitions.

As to short-term liquidity commitments, we have entered into an agreement to complete construction of a 75-unit assisted living community in Columbia, South Carolina and a 46-unit assisted living addition to our Franklin, Tennessee community. At March 31, 2011, we are obligated on construction contracts in the amount of approximately \$1,695,000, all of which is expected to require funding within the next twelve months.

We expect to meet our short-term liquidity requirements primarily from our cash flows from operating activities. In addition to cash flows from operations, our current cash on hand of \$33,504,000 at March 31, 2011, marketable securities of \$90,881,000 at March 31, 2011 and as needed, our borrowing capacity, are expected to be adequate to meet our contractual obligations and to finance our operating requirements and our growth and development plans in the next twelve months.

Long-term liquidity

Our \$75,000,000 revolving credit agreement matures on October 25, 2011. We currently anticipate renewing the credit agreement at that time and while we have had no indication from the lender that there is any question about

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renewal, there has been no commitment at this time. We entered into this loan originally on October 30, 2007, and have renewed the loan three times with one year maturities. At the inception and at each renewal, the lender offered longer maturities, but the Company chose a one-year maturity because of the terms. If we are not able to refinance our debt as it matures, we will be required to use our cash and marketable securities to meet our debt and contractual obligations and will be limited in our ability to fund future growth opportunities.

Our ability to refinance the credit agreement, to meet our long-term contractual obligations and to finance our operating requirements, and growth and development plans will depend upon our future performance, which will be affected by business, economic, financial and other factors, including potential changes in state and federal government payment rates for healthcare, customer demand, success of our marketing efforts, pressures from competitors, and the state of the economy, including the state of financial and credit markets.

### Guarantees and Contingencies

#### *Debt Guarantees*

At March 31, 2011, we have no guaranteed debt obligations.

#### *Governmental Regulations*

Laws and regulations governing the Medicare, Medicaid and other federal healthcare programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations in all material respects. However, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusions from the Medicare, Medicaid and other federal healthcare programs. We are not aware of any material regulatory proceeding or

investigation underway or threatened involving allegations of potential wrongdoing.

On July 24, 2009, the Company received a civil investigative demand from the Tennessee Attorney General's Office, requesting production of documents related to NHC's business relationships with non-profit entities. The Company has responded to the demand and complied as required with the terms of the demand.

### *Acquisitions*

We have acquired and will continue to acquire businesses with prior operating histories. Acquired companies may have unknown or contingent liabilities, including liabilities for failure to comply with healthcare laws and regulations, such as billing and reimbursement, anti-kickback and physician self-referral laws. Although we institute policies designed to conform practices to our standards following completion of acquisitions and attempts to structure our acquisitions as asset acquisitions in which we do not assume liability for seller wrongful actions, there can be no assurance that we will not become liable for past activities that may later be alleged to be improper by private plaintiffs or government agencies. Although we obtain general indemnifications from sellers covering such matters, there can be no assurance that any specific matter will be covered by such indemnifications, or if covered, that such indemnifications will be adequate to cover potential losses and fines.

### New Accounting Pronouncements

See Note 13 to the Interim Condensed Consolidated Financial Statements for the impact of new accounting standards.

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Forward Looking Statements

References throughout this document to the Company include National HealthCare Corporation and its wholly owned subsidiaries. In accordance with the Securities and Exchange Commissions Plain English guidelines, this Quarterly Report on Form 10 Q has been written in the first person. In this document, the words we , our , ours and us refer to National HealthCare Corporation and its wholly owned subsidiaries and not any other person.

This Quarterly Report on Form 10 Q and other information we provide from time to time, contains certain forward looking statements as that term is defined by the Private Securities Litigation Reform Act of 1995. All statements regarding our expected future financial position, results of operations or cash flows, continued performance improvements, ability to service and refinance our debt obligations, ability to finance growth opportunities, ability to control our patient care liability costs, ability to respond to changes in government regulations, ability to execute our three year strategic plan, and similar statements including, without limitations, those containing words such as believes , anticipates , expects , intends , estimates , plans , and other similar expressions are forward looking statements.

Forward looking statements involve known and unknown risks and uncertainties that may cause our actual results in future periods to differ materially from those projected or contemplated in the forward looking statements as a result of, but not limited to, the following factors:

C

national and local economic conditions, including their effect on the availability and cost of labor, utilities and materials;

C

the effect of government regulations and changes in regulations governing the healthcare industry, including our compliance with such regulations;



C

changes in Medicare and Medicaid payment levels and methodologies and the application of such methodologies by the government and its fiscal intermediaries;

C

liabilities and other claims asserted against us, including patient care liabilities, as well as the resolution of current litigation (see Note 12: Guarantees and Contingencies);

C

the ability of third parties for whom we have guaranteed debt, if any, to refinance certain short term debt obligations;

C

the ability to attract and retain qualified personnel;

C

the availability and terms of capital to fund acquisitions and capital improvements;

C

the ability to refinance existing debt on favorable terms;

C

the competitive environment in which we operate;

C

the ability to maintain and increase census levels; and

C

demographic changes.

See the notes to the quarterly financial statements, and Item 1. Business as is found in our 2010 Annual Report on Form 10-K for a discussion of various governmental regulations and other operating factors relating to the healthcare industry and the risk factors inherent in them. This may be found on our web site at [www.nhccare.com](http://www.nhccare.com). You should carefully consider these risks before making any investment in the Company. These risks and uncertainties are not

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the only ones facing us. There may be additional risks that we do not presently know of or that we currently deem immaterial. If any of the risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of our shares of stock could decline, and you may lose all or part of your investment. Given these risks and uncertainties, we can give no assurances that these forward looking statements will, in fact, transpire and, therefore, caution investors not to place undue reliance on them.

**Item 3.**

**Quantitative and Qualitative Disclosures About Market Risk.**

Market risk represents the potential economic loss arising from adverse changes in the fair value of financial instruments. Currently, our exposure to market risk relates primarily to our fixed-income and equity portfolios. These investment portfolios are exposed primarily to, but not limited to, interest rate risk, credit risk, equity price risk, and concentration risk. We also have exposure to market risk that includes our cash and cash equivalents, notes receivable, revolving credit facility, and long-term debt. The Company's senior management has established comprehensive risk management policies and procedures to manage these market risks.

*Interest Rate Risk*

The fair values of our fixed-income investments fluctuate in response to changes in market interest rates. Increases and decreases in prevailing interest rates generally translate into decreases and increases, respectively, in the fair values of those instruments. Additionally, the fair values of interest rate sensitive instruments may be affected by the creditworthiness of the issuer, prepayment options, the liquidity of the instrument and other general market conditions. At March 31, 2011, we have available for sale debt securities in the amount of \$69,504,000. The fixed maturity portfolio is comprised of investments with primarily short-term and intermediate-term maturities. The portfolio composition allows flexibility in reacting to fluctuations of interest rates. The fixed maturity portfolio allows our insurance company subsidiaries to achieve an adequate risk-adjusted return while maintaining sufficient liquidity to meet obligations.

As of March 31, 2011, both our long-term debt and revolving credit facility bear interest at variable interest rates. Currently, we have long-term debt outstanding of \$10.0 million and the revolving credit facility is zero. However, we do intend to borrow funds on our credit facility in the future. Based on a hypothetical credit facility borrowing of \$75 million and our outstanding long-term debt, a 1% change in interest rates would change our annual interest cost by approximately \$850,000.

Approximately \$5.6 million of our notes receivable bear interest at variable rates (generally at the prime rate plus 2%). Because the interest rates of these instruments are variable, a hypothetical 1% change in interest rates would result in a related increase or decrease in interest income of approximately \$56,000.

Our cash and cash equivalents consist of highly liquid investments with a maturity of less than three months when purchased. As a result of the short-term nature of our cash instruments, a hypothetical 1% change in interest rates would have minimal impact on our future earnings and cash flows related to these instruments.

We do not currently use any derivative instruments to hedge our interest rate exposure. We have not used derivative instruments for trading purposes and the use of such instruments in the future would be subject to approvals by the Investment Committee of the Board.

#### *Credit Risk*

Credit risk is managed by diversifying the fixed maturity portfolio to avoid concentrations in any single industry group or issuer and by limiting investments in securities with lower credit ratings.

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*Equity Price and Concentration Risk*

Our available for sale equity securities are recorded at their fair market value based on quoted market prices. Thus, there is exposure to equity price risk, which is the potential change in fair value due to a change in quoted market prices. At March 31, 2011, the fair value of our equity marketable securities is approximately \$90,881,000. Of the \$90.8 million equity securities portfolio, our investment in National Health Investors, Inc. ( NHI ) comprises approximately \$78,140,000, or 86.0%, of the total fair value. We manage our exposure to NHI by closely monitoring the financial condition, performance, and outlook of the company. Hypothetically, a 10% change in quoted market prices would result in a related increase or decrease in the fair value of our equity investments of approximately \$9,088,000. At March 31, 2011, our equity securities had unrealized gains of \$61,277,000 and no unrealized losses. Of the \$61,277,000 unrealized gains, \$53,406,000 is related to NHI.

**Item 4. Controls and Procedures.**

As of March 31, 2011, an evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer ( CEO ) and Principal Accounting Officer ( PAO ), of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the CEO and PAO, concluded that the Company's disclosure controls and procedures were effective as of March 31, 2011. There have been no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

For a discussion of prior, current and pending litigation of material significance to NHC, please see Note 12 of this Form 10-Q.

**Item 1A. Risk Factors.**

During the three months ended March 31, 2011, there were no material changes to the risk factors that were disclosed in Item 1A of National HealthCare Corporation's Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.** Not applicable

**Item 3. Defaults Upon Senior Securities.** None

**Item 5. Other Information.** None

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(unaudited)

**Item 6. Exhibits.**

(a)

List of exhibits

<u>Exhibit No.</u>	<u>Description</u>
31.1	Rule 13a 14(a)/15d 14(a) Certification of Chief Executive Officer
31.2	Rule 13a 14(a)/15d 14(a) Certification of Principal Financial Officer
32	Certification pursuant to 18 U.S.C. Section 906 by Chief Executive Officer and Principal Financial Officer

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NATIONAL HEALTHCARE  
CORPORATION

(Registrant)

Date: May 9, 2011

/ s / R o b e r t G . A d a m s

Robert G. Adams  
Chief Executive Officer

Date: May 9, 2011

/ s / D o n a l d K . D a n i e l

Donald K. Daniel  
Senior Vice President and Controller  
(Principal Financial Officer)