NATIONAL HEALTHCARE CORP
Form 10-Q
May 09, 2014

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

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014
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	52–2057472
(State or other jurisdiction of incorporation or organization	(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 [x] 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 [x] 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 [x]
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 [x]

14,219,873 shares of common stock of the registrant were outstanding as of May 6, 2014.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Statements of Income

(in thousands, except share and per share amounts)

(unaudited)

	Three Months Ended March 31	
	2014	2013
Revenues:		
Net patient revenues	$ 199,769	$ 178,430
Other revenues	10,762	15,948
Net operating revenues	210,531	194,378
Cost and Expenses:		
Salaries, wages and benefits	119,725	107,063
Other operating	55,742	54,411
Facility rent	9,886	9,868
Depreciation and amortization	7,900	6,956
Interest	290	84
Total costs and expenses	193,543	178,382
Income Before Non–Operating Income	16,988	15,996
Non–Operating Income	4,572	6,618
Income Before Income Taxes	21,560	22,614
Income Tax Provision	(8,331)	(8,809)
Net Income	13,229	13,805
Dividends to Preferred Stockholders	(2,168)	(2,168)
Net Income Available to Common Stockholders	$ 11,061	$ 11,637
Earnings Per Common Share:		

Basic	$ 0.80	$ 0.84
Diluted	$ 0.78	$ 0.82
Weighted Average Common Shares Outstanding:		
Basic	13,843,190	13,861,584
Diluted	14,170,453	14,111,752
Dividends Declared Per Common Share	$ 0.32	$ 0.30

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 Comprehensive Income

(unaudited – in thousands)

	Three Months Ended March 31	
	2014	2013
Net Income	$ 13,229	$ 13,805
Other Comprehensive Income:		
Unrealized gains on investments in marketable securities	9,598	15,764
Reclassification adjustment for realized gains on sale of securities	(136)	(230)
Income tax expense related to items of other comprehensive income	(3,650)	(6,090)
Other comprehensive income, net of tax	5,812	9,444
Comprehensive Income	$ 19,041	$ 23,249

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, 2014 *unaudited*	December 31, 2013
Assets		
Current Assets:		
Cash and cash equivalents	$ 84,137	$ 81,705
Restricted cash and cash equivalents	17,163	13,929
Marketable securities	113,461	105,009
Restricted marketable securities	140,078	142,003
Accounts receivable, less allowance for doubtful accounts of $5,431 and $4,972, respectively	86,949	85,511
Inventories	7,260	7,146
Prepaid expenses	2,977	1,208
Notes receivable	285	417
Total current assets	452,310	436,928
Property and Equipment:		
Property and equipment, at cost	782,980	734,682
Accumulated depreciation and amortization	(285,779)	(277,884)
Net property and equipment	497,201	456,798
Other Assets:		
Deposits and other assets	1,858	1,153
Goodwill	17,600	17,600
Notes receivable	15,828	14,961
Deferred income taxes	16,451	14,531
Investments in limited liability companies	36,056	38,754
Total other assets	87,793	86,999
Total assets	$ 1,037,304	$ 980,725

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 (continued)

(in thousands, except share and per share amounts)

	March 31, 2014 *unaudited*	December 31, 2013
Liabilities and Stockholders' Equity		
Current Liabilities:		
Trade accounts payable	$ 17,973	$ 13,050
Capital lease obligations, current portion	2,953	-
Accrued payroll	40,679	63,462
Amounts due to third party payors	22,508	21,619
Accrued risk reserves	112,304	110,557
Deferred income taxes	24,859	21,157
Other current liabilities	20,160	13,784
Dividends payable	6,784	6,730
Total current liabilities	248,220	250,359
Long–term debt	10,000	10,000
Capital lease obligations, less current portion	35,841	-
Refundable entrance fees	11,187	10,720
Obligation to provide future services	3,689	3,689
Other noncurrent liabilities	15,171	14,525
Deferred revenue	5,695	3,320
Stockholders' Equity:		
Series A Convertible Preferred Stock; $.01 par value; 25,000,000 shares authorized; 10,837,500 and 10,837,665 shares, respectively, issued and outstanding; stated at liquidation value of $15.75 per share	170,507	170,510
Common stock, $.01 par value; 30,000,000 shares authorized; 14,219,773 and 14,078,028 shares, respectively, issued and outstanding	142	141
Capital in excess of par value	160,128	153,060
Retained earnings	324,727	318,216
Accumulated other comprehensive income	51,997	46,185
Total stockholders' equity	707,501	688,112
Total liabilities and stockholders' equity	$ 1,037,304	$ 980,725

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 Cash Flows

(unaudited – in thousands)

	Three Months Ended March 31 2014	2013
Cash Flows From Operating Activities:		
Net income	$ 13,229	$ 13,805
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,900	6,956
Provision for doubtful accounts receivable	1,503	806
Equity in earnings of unconsolidated investments	(1,913)	(3,806)
Distributions from unconsolidated investments	5,317	2,022
Gains on sale of marketable securities	(136)	(230)
Deferred income taxes	(1,868)	(1,171)
Stock–based compensation	482	498
Changes in operating assets and liabilities, net of the effect of acquisitions:		
Restricted cash and cash equivalents	1,285	(5,125)
Accounts receivable	(2,941)	(1,800)
Income tax receivable	–	5,933
Inventories	(114)	102
Prepaid expenses and other assets	(1,769)	(1,785)
Trade accounts payable	4,923	393
Accrued payroll	(22,783)	(1,858)
Amounts due to third party payors	889	(175)
Other current liabilities and accrued risk reserves	8,123	6,807
Other noncurrent liabilities	646	572
Deferred revenue	2,375	2,904
Net cash provided by operating activities	15,148	24,848
Cash Flows From Investing Activities:		
Additions to property and equipment	(9,271)	(6,366)
Investments in unconsolidated limited liability companies	(706)	–
Investments in notes receivable	(767)	–
Collections of notes receivable	32	394
Change in restricted cash and cash equivalents	(4,519)	(688)
Purchase of marketable securities	(21,382)	(22,193)
Sale of marketable securities	24,453	22,055
Net cash used in investing activities	(12,160)	(6,798)
Cash Flows From Financing Activities:		
Tax benefit from stock–based compensation	108	–
Principal payments under capital lease obligations	(238)	–
Dividends paid to preferred stockholders	(2,168)	(2,168)

Dividends paid to common stockholders		(4,496)		(4,236)
Issuance of common shares		6,476		–
Repurchase of common shares		–		(4,700)
Entrance fee deposits		467		157
Change in deposits		(705)		35
Net cash used in financing activities		(556)		(10,912)
Net Increase in Cash and Cash Equivalents		2,432		7,138
Cash and Cash Equivalents, Beginning of Period		81,705		66,701
Cash and Cash Equivalents, End of Period	$	84,137	$	73,839
Supplemental disclosure of non-cash investing and financing activities:				
Buildings, personal property, and obligations recorded under capital lease agreements	$	39,032	$	–

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 Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance at January 1, 2013	10,838,412	$ 170,514	14,158,127	$ 142	$ 154,691	$ 279,993	$ 50,808	$ 656,148
Net income	–	–	–	–	–	13,805	–	13,805
Other comprehensive income	–	–	–	–	–	–	9,444	9,444
Stock–based compensation	–	–	–	–	498	–	–	498
Repurchase of common stock	–	–	(100,000)	(1)	(4,699)	–	–	(4,700)
Shares issued in conversion of preferred stock to common stock	(107)	(2)	25	–	2	–	–	–
Dividends declared to preferred stockholders ($0.20 per share)	–	–	–	–	–	(2,168)	–	(2,168)
Dividends declared to common stockholders ($0.30 per	–	–	–	–	–	(4,217)	–	(4,217)

share)								
Balance at March 31, 2013	10,838,305	$ 170,512	14,058,152	$ 141	$ 150,492	$ 287,413	$ 60,252	$ 668,810
Balance at January 1, 2014	10,837,665	$ 170,510	14,078,028	$ 141	$ 153,060	$ 318,216	$ 46,185	$ 688,112
Net income	–	–	–	–	–	13,229	–	13,229
Other comprehensive income	–	–	–	–	–	–	5,812	5,812
Stock–based compensation	–	–	–	–	482	–	–	482
Tax expense from exercise of stock options	–	–	–	–	108	–	–	108
Shares sold – options exercised	–	–	141,706	1	6,475	–	–	6,476
Shares issued in conversion of preferred stock to common stock	(165)	(3)	39	–	3	–	–	–
Dividends declared to preferred stockholders ($0.20 per share)	–	–	–	–	–	(2,168)	–	(2,168)
Dividends declared to common stockholders ($0.32 per share)	–	–	–	–	–	(4,550)	–	(4,550)
Balance at March 31, 2014	10,837,500	$ 170,507	14,219,773	$ 142	$ 160,128	$ 324,727	$ 51,997	$ 707,501

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

NATIONAL HEALTHCARE CORPORATION

Notes to Interim Condensed Consolidated Financial Statements

March 31, 2014

(unaudited)

Note 1 – Description of Business

National HealthCare Corporation ("NHC" or the "Company") is a leading provider of senior health care services. We operate or manage, through certain affiliates, 73 skilled nursing centers with 9,410 beds in nine states and provide other senior health care services in one additional state. These operations are provided by separately funded and maintained subsidiaries. We provide health care services to patients in a variety of settings including skilled nursing centers, managed care specialty units, sub–acute care units, Alzheimer's care units, homecare programs, assisted living centers and independent living centers. We also have a non-controlling ownership interest in a hospice care business that services NHC owned health care centers and others. In addition, we provide insurance services, management and accounting services, and lease properties to operators of skilled nursing centers.

Note 2 – Summary of Significant Accounting Policies

The listing below is not intended to be a comprehensive list of all of our significant 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 December 31, 2013 consolidated financial statements and notes thereto which contain accounting policies and other disclosures required by generally accepted accounting principles. Our audited December 31, 2013 consolidated financial statements are available at our web site: www.nhccare.com.

Basis of Presentation

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 NHC. All significant intercompany transactions and balances have been eliminated in consolidation. We assume that users of these interim financial statements have read or have access to the audited December 31, 2013 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.

Estimates and Assumptions

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 could cause our reported net income to vary significantly from period to period.

Revenue Recognition – Third Party Payors

Approximately 67% 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 $22,508,000 and

$21,619,000 as of March 31, 2014 and December 31, 2013, respectively, 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 with payment being due 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 senior care facilities and to others we provide accounting and financial services. We generally charge 6% to 7% of net operating 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 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. We believe 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.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is provided by the straight-line method over the expected useful lives of the assets estimated as follows: buildings and improvements, 20-40 years and equipment and furniture, 3-15 years. Leasehold improvements are amortized over periods that do not exceed the non-cancelable respective lease terms using the straight-line method.

Capital leases are recorded at the lower of fair market value or the present value of future minimum lease payments. Capital leases are amortized in accordance with the provision codified within Accounting Standards Codification ("ASC") Subtopic 840-30, *Leases – Capital Leases*. Amortization of capital lease assets is included in depreciation and amortization expense.

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 our workers' compensation and professional and general liability claims is to use an external, independent 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.

Professional liability remains an area of particular concern to us. The entire long term care industry has seen an 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, 2014, we and/or our managed centers are defendants in 33 such claims inclusive of years 2005 through March 31, 2014. It remains possible that those pending matters plus potential unasserted claims could exceed our reserves, which could have a material adverse effect on our consolidated 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 centers owned or leased 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.

Continuing Care Contracts and Refundable Entrance Fees

We have one continuing care retirement center ("CCRC") within our operations. Residents at this retirement center may enter into continuing care contracts with us. The contract provides that 10% of the resident entry fee becomes non-refundable upon occupancy, and the remaining refundable portion of the entry fee is calculated using the lessor of the price at which the apartment is re-assigned or 90% of the original entry fee, plus 40% of any appreciation if the apartment exceeds the original resident's entry fee. In each case, we amortize the non-refundable part of these fees into revenue over the actuarially determined remaining life of the resident, which is the expected period of occupancy by the resident. We pay the refundable portion of our entry fees when residents relocate from our community and the apartment is re-occupied. Refundable entrance fees are classified as non-current liabilities and non-refundable entrance fees are classified as deferred revenue in the Company's consolidated balance sheets. The balances of refundable entrance fees as of March 31, 2014 and December 31, 2013 were $11,187,000 and $10,720,000, respectively.

Obligation to Provide Future Services

The CCRC annually calculates the present value of the net cost of future services and the use of facilities to be provided to the current residents and compares that amount with the balance of non-refundable deferred revenue from entrance fees received. If the present value of the net cost of future services exceeds the related anticipated revenues, a liability is recorded (obligation to provide future services) with a corresponding charge to income. As of March 31, 2014 and December 31, 2013, we have recorded a future service obligation in the amount of $3,689,000.

Deferred Revenue

Deferred revenue includes the deferred gain on the sale of assets to National, the non-refundable portion (10%) of CCRC entrance fees being amortized over the remaining life expectancies of the residents, and premiums received within our workers' compensation and professional liability companies that are not yet earned.

New Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." This standard changes the requirements for reporting discontinued operations by raising the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. The standard limits discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results. This standard is effective for the Company on a prospective basis for annual periods beginning on January 1, 2015 and interim periods within that year. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued. When adopted, the Company does not expect this standard to have a material impact on our consolidated financial statements.

Note 3 – Other Revenues

Other revenues are outlined in the table below. Revenues from management and accounting services include management and accounting fees provided to managed and other health care centers. Revenues from rental income include health care real estate properties owned by us and leased to third party operators. 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 health care centers to which we provide management or accounting services. "Other" revenues include miscellaneous health care related earnings.

Other revenues include the following:

	Three Months Ended March 31	
(in thousands)	2014	2013
Management and accounting services fees	$ 3,982	$ 4,832
Rental income	4,768	4,737
Insurance services	1,773	6,127
Other	239	252
	$ 10,762	$ 15,948

Management Fees from National

We manage five skilled nursing facilities owned by National Health Corporation ("National"). For the three months ended March 31, 2014, we recognized management fees and interest on management fees of $925,000 from these centers. For the three months ended March 31, 2013, we recognized management fees and interest on management fees of $912,000 from these centers.

Because the amount collectable cannot be reasonably determined when the management services are provided, and because we cannot estimate the timing or amount of expected future collections, the unpaid fees from the five centers owned by National will be recognized as revenues only when the collectability 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.

Management Fees from Other Healthcare Centers

During the first quarter of 2014, we assumed management of a 121-bed skilled nursing facility located in Des Peres, Missouri. As of March 31, 2014, we provide management services to five healthcare centers operated by third party owners. For the three months ended March 31, 2014, we recognized management fees of $537,000 from these centers. In the first quarter of 2013, we provided management services to 21 healthcare centers operated by third party owners. For the three months ended March 31, 2013, we recognized management fees of $1,619,000 from these centers. The decrease in management services revenues is due to the discontinuation of management services to the non-profit entities SeniorTrust and ElderTrust. Effective September 1, 2013, we began leasing and operating the former ElderTrust facilities from National Health Investors, Inc. ("NHI"). The revenues from these seven facilities are included in net patient revenues in the interim condensed consolidated statement of income.

Insurance Services

For workers' compensation insurance operations, the premium revenues reflected in the interim condensed consolidated statements of income for the three months ended March 31, 2014 and 2013, respectively, are $1,096,000 and $3,609,000. For the three months ended March 31, 2013, there was a non-recurring positive insurance settlement reached with one of the states in which we provide workers' compensation insurance. The

2013 prior period event helped increase other revenues in the amount of $2,268,000. Associated losses and expenses are reflected in the interim condensed consolidated statements of income as "Salaries, wages and benefits."

For professional liability insurance operations, the premium revenues reflected in the interim condensed consolidated statements of income for the three months ended March 31, 2014 and 2013, respectively, are $677,000 and $962,000. Associated losses and expenses including those for self–insurance are included in the interim condensed consolidated statements of income as "Other operating costs and expenses".

Note 4 – 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 marketable securities, and interest income. Our most significant equity method investment is a 75.1% non–controlling ownership interest in Caris HealthCare L.P. ("Caris"), a business that specializes in hospice care services.

	Three Months Ended March 31	
(in thousands)	2014	2013
Equity in earnings of unconsolidated investments	$ 1,914	$ 3,806
Dividends and other net realized gains and losses on sales of securities	1,526	1,461
Interest income	1,132	1,351
	$ 4,572	$ 6,618

Note 5 – Long-Term Leases

Capital Leases

Effective March 1, 2014, NHC began leasing and operating three senior healthcare facilities in the state of Missouri under three separate lease agreements. Two of the healthcare facilities are skilled nursing facilities that also include assisted living facilities and the third healthcare facility is a memory care facility. Each of the leases is a ten year lease with two, five year renewal options. Under the terms of the leases, base rent totals $5,200,000 annually with rent thereafter escalating by 4% of the increase in facility revenue over the 2014 base year. The leases also contain certain non-performance default provisions which result in capital lease classification. However, the initial measurement and recording of the capital lease assets and obligations does not include any expected payments under such default provisions, as the Company does not expect to incur an obligation to such payments.

Fixed assets recorded under the capital leases, which are included in property and equipment in the interim condensed consolidated balance sheets, are as follows:

	March 31, 2014	December 31, 2013
	(in thousands)	
Buildings and personal property	$ 39,032	$ –
Accumulated amortization	(327)	–
	$ 38,705	$ –

Operating Leases

At March 31, 2014, NHC leases from NHI the real property of 35 skilled nursing facilities, seven assisted living facilities and three independent living facilities under two separate lease agreements. Base rent expense under both lease agreements totals $34,200,000 annually with rent thereafter escalating by 4% of the increase in facility revenue over the base year. Total facility rent expense to NHI was $9,133,000 and $9,083,000 for the three months ended March 31, 2014 and 2013, respectively.

Minimum Lease Payments

The approximate future minimum lease payments required under all leases that have remaining non-cancelable lease terms at March 31, 2014 are as follows:

	Operating Leases	Capital Leases
	(in thousands)	
2015	$ 34,200	$ 5,200
2016	34,200	5,200
2017	34,200	5,200
2018	34,200	5,200
2019	34,200	5,200
Thereafter	270,800	25,567
Total minimum lease payments	$ 441,800	$ 51,567
Less: Amounts representing interest		(12,773)
Present value of minimum lease payments		38,794
Less: Current portion		(2,953)
Long-term capital lease obligations		$ 35,841

Note 6 – 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, and professional liability insurance and licensing fees. The primary facility costs include utilities and property insurance.

Note 7 – 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.

(in thousands, except for share and per share amounts)	Three Months Ended March 31 2014		2013	
Basic:				
Weighted average common shares outstanding		13,843,190		13,861,584
Net income	$	13,229	$	13,805
Dividends to preferred stockholders		2,168		2,168
Net income available to common stockholders		11,061		11,637
Earnings per common share, basic	$	0.80	$	0.84
Diluted:				
Weighted average common shares outstanding		13,843,190		13,861,584
Dilutive effect of stock options		44,457		9,799
Dilutive effect of restricted stock		6,348		7,369
Dilutive effect of contingent issuable stock		276,458		233,000
Assumed average common shares outstanding		14,170,453		14,111,752
Net income available to common stockholders	$	11,061	$	11,637
Earnings per common share, diluted	$	0.78	$	0.82

In the above table, options to purchase 13,300 and 1,048,640 shares of our common stock have been excluded for the three months ended March 31, 2014 and 2013, respectively, due to their anti–dilutive impact. We have also excluded 2,623,109 and 2,623,303 of common shares issuable upon the conversion of preferred stock for the three months ended March 31, 2014 and 2013, respectively, due to their anti-dilutive impact.

Note 8 – Investments in Marketable Securities

Our investments in marketable securities are classified as available for sale securities. Realized gains and losses from securities sales are recognized in results of operations upon disposition of the securities using the specific identification method on a trade date basis. Refer to Note 9 for a description of the Company's methodology for determining the fair value of marketable securities.

Marketable securities and restricted marketable securities consist of the following:

	March 31, 2014		December 31, 2013	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investments available for sale:				
Marketable equity securities	$ 30,176	$ 113,461	$ 30,176	$ 105,009
Restricted investments available for sale:				
Corporate debt securities	66,442	66,122	65,852	65,006
Commercial mortgage–backed securities	54,003	53,253	46,977	45,856
U.S. Treasury securities	12,389	12,326	22,932	22,841
State and municipal securities	8,115	8,377	8,123	8,300
	$ 171,125	$ 253,539	$ 174,060	$ 247,012

Included in the available for sale marketable equity securities are the following *(in thousands, except share amounts):*

	March 31, 2014			December 31, 2013		
	Shares	Cost	Fair Value	Shares	Cost	Fair Value
NHI Common Stock	1,630,642	$ 24,734	$ 98,589	1,630,642	$ 24,734	$ 91,479

The amortized cost and estimated fair value of debt securities classified as available for sale, by contractual maturity, are as follows:

	March 31, 2014		December 31, 2013	
(in thousands)	Cost	Fair Value	Cost	Fair Value
Maturities:				
Within 1 year	$ 9,328	$ 9,363	$ 9,279	$ 9,324
1 to 5 years	89,786	90,276	91,787	92,011
6 to 10 years	38,154	37,070	40,387	38,335
Over 10 years	3,681	3,369	2,431	2,333
	$ 140,949	$ 140,078	$ 143,884	$ 142,003

Gross unrealized gains related to available for sale securities are $84,260,000 and $75,702,000 as of March 31, 2014 and December 31, 2013, respectively. Gross unrealized losses related to available for sale securities are $1,846,000 and $2,750,000 as of March 31, 2014 and December 31, 2013, respectively. For the marketable securities in gross unrealized loss positions, (a) it is more likely than not that the Company will not be required to sell the investment securities before recovery of the unrealized losses, and (b) the Company expects that the contractual principal and interest will be received on the investment securities. These securities have also been in an unrealized loss position for a period of less than twelve months. As a result, the Company recognized no other-than-temporary impairment during the three months ended March 31, 2014 or the year ended December 31, 2013.

Proceeds from the sale of investments in restricted marketable securities during the three months ended March 31, 2014 and 2013 were $24,453,000 and $22,055,000, respectively. Investment gains of $136,000 and $230,000 were realized on these sales during the three months ended March 31, 2014 and 2013, respectively.

Note 9 – Fair Value Measurements

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.

Valuation of Marketable Securities

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 validated the prices provided by our broker by reviewing their pricing methods, obtaining market values from other pricing sources, analyzing pricing data in certain instances and confirming that the relevant markets are active. After completing our validation procedures, we did not adjust or override any fair value measurements provided by our broker as of March 31, 2014. We did not have any transfers of assets between Level 1 and Level 2 of the fair value measurement hierarchy during the three months ended March 31, 2014.

Other

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, but fair value is also determined using Level 2 inputs through alternative pricing sources. At March 31, 2014, there were no material differences between the carrying amounts and fair values of NHC's financial instruments.

The following table summarizes fair value measurements by level at March 31, 2014 and December 31, 2013 for assets and liabilities measured at fair value on a recurring basis *(in thousands)*:

		Fair Value Measurements Using		
March 31, 2014	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 84,137	$ 84,137	$ –	$ –
Restricted cash and cash equivalents	17,163	17,163	–	–
Marketable equity securities	113,461	113,461	–	–
Corporate debt securities	66,122	–	66,122	–
Commercial mortgage–backed securities	53,253	–	53,253	–
U.S. Treasury securities	12,326	12,326	–	–

State and municipal securities		8,377		–		8,377		–
Total financial assets	$	354,839	$	227,087	$	127,752	$	–

December 31, 2013		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)
Cash and cash equivalents	$	81,705	$	81,705	$	–	$	–
Restricted cash and cash equivalents		13,929		13,929		–		–
Marketable equity securities		105,009		105,009		–		–
Corporate debt securities		65,006		–		65,006		–
Commercial mortgage–backed securities		45,856		–		45,856		–
U.S. Treasury securities		22,841		22,841		–		–
State and municipal securities		8,300		–		8,300		–
Total financial assets	$	342,646	$	223,484	$	119,162	$	–

Note 10 – Long–Term Debt

Long–term debt consists of the following:

	Weighted Average Interest Rate	Maturities	3/31/14		12/31/13	
			(dollars in thousands)			
Revolving Credit Facility, interest payable monthly	Variable, 0.9%	2014	$	–	$	–
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 11 – $75,000,000 Revolving Credit Facility

Effective October 23, 2013, 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 0.70% or (ii) the prime rate. Letter of credit fees are equal to 0.10% times the maximum amount available to be drawn under outstanding letters of credit.

Commitment fees are payable on the daily unused portion of the Credit Facility at a rate of ten (10) 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 22, 2014. We currently anticipate renewing the credit agreement at that time and while we have had no indication from the lender there is any question about renewal, there has been no commitment at this time. 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.

Note 12 - Stock Repurchase Program

On August 1, 2013, the Board of Directors of the Company authorized a new stock repurchase program that will allow the Company to repurchase up to $25 million of its common stock over a one year period. The program expires on July 31, 2014. Under the stock repurchase program, the Company may repurchase its common stock from time to time, in amounts and at prices the Company deems appropriate, subject to market conditions and other considerations. The Company's repurchases may be executed using open market purchases, privately negotiated agreements or other transactions. The Company intends to fund repurchases under the new stock repurchase program from cash on hand, available borrowings or proceeds from potential debt or other capital market sources. The stock repurchase program may be suspended or discontinued at any time without prior notice. As of March 31, 2014, no repurchases of common stock have been executed under this program.

Note 13 – Stock–Based Compensation

NHC recognizes stock–based compensation expense 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 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 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. At March 31, 2014, 245,620 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. The shares granted during the three months ended March 31, 2014 consisted of 13,300 shares through the Employee Stock Purchase Plan. At March 31, 2014, 397,960 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 $482,000 and $498,000 for the three months ended March 31, 2014 and 2013, respectively. At March 31, 2014, we had $3,484,000 of unrecognized compensation cost related to unvested stock–based compensation awards, which consisted of $3,257,000 for stock options and $227,000 for restricted stock. This expense will be recognized over the remaining weighted average vesting period, which is approximately 1.9 years for stock options and 0.6 years for restricted stock. Stock–based compensation is included in "Salaries, wages and benefits" in the interim condensed consolidated statements of income.

Stock Options

The following table summarizes the significant assumptions used to value the options granted for the three months ended March 31, 2014 and for the year ended December 31, 2013.

	2014	2013
Risk–free interest rate	0.13%	0.25%
Expected volatility	13.75%	31.3%
Expected life, in years	1.0 year	2.1 years
Expected dividend yield	2.49%	2.81%

The following table summarizes our outstanding stock options for the three months ended March 31, 2014 and for the year ended December 31, 2013.

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Options outstanding at January 1, 2013	1,134,602	$ 46.75	$ –
Options granted	59,472	47.95	–
Options exercised	(21,522)	45.63	–
Options cancelled	(98,000)	51.11	–
Options outstanding at December 31, 2013	1,074,552	46.44	–
Options granted	13,300	53.72	–
Options exercised	(141,706)	45.70	–
Options outstanding at March 31, 2014	946,146	$ 46.65	$ 8,626,000
Options exercisable at March 31, 2014	120,741	$ 45.62	$ 1,225,000

Options Outstanding	Exercise Prices	Weighted Average Exercise Price	Weighted Average Remaining Contractual

March 31, 2014				Life in Years
7,168	$37.70	$	37.70	0.1
925,678	$44.80 - $47.45		46.62	2.1
13,300	$53.72		53.72	0.9
946,146		$	46.65	2.0

Restricted Stock

The following table summarizes our restricted stock activity for the three months ended March 31, 2014 and for the year ended December 31, 2013.

	Number of Shares	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Non–vested restricted shares at January 1, 2013	18,000	$ 34.46	$ –
Award shares granted	–	–	–
Award shares vested	6,000	34.46	–
Non–vested restricted shares at December 31, 2013	12,000	34.46	–
Award shares granted	–	–	–
Award shares vested	–	–	–
Non–vested restricted shares at March 31, 2014	12,000	$ 34.46	$ 256,000

The weighted average remaining contractual life of restricted stock at March 31, 2014 is 0.6 years.

Note 14 – Accounting for Uncertainty in Income Taxes

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, 2014, we had $12,880,000 of unrecognized tax benefits, composed of $8,680,000 of deferred tax assets and $4,200,000 of permanent differences. Accrued interest and penalties of $2,291,000 relate to unrecognized tax benefits at March 31, 2014. Unrecognized tax benefits of $4,200,000, net of federal benefit, at

March 31, 2014, attributable to permanent differences, would favorably impact our effective tax rate if recognized. Accrued interest and penalties of $2,010,000 relate to these permanent differences at March 31, 2014. We do not expect to recognize significant increases or decreases in unrecognized tax benefits within the twelve months beginning March 31, 2014, except for the effect of decreases related to the lapse of statute of limitations estimated at $2,330,000, composed of temporary differences of $1,390,000, and permanent tax differences of $940,000. Interest and penalties of $557,000 relate to these temporary and permanent difference changes within 12 months beginning March 31, 2014.

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 2010 (with certain state exceptions). Currently, there are no U.S. federal or state returns under examination.

Our deferred tax assets have been evaluated for realization based on historical taxable income, tax planning strategies, the expected timing of reversals of existing temporary differences and future taxable income anticipated. Our deferred tax assets are more likely than not to be realized in full due to the existence of sufficient taxable income of the appropriate character under the tax law. As such, there is no need for a valuation allowance.

Note 15 – 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 $112,304,000 and $110,557,000 at March 31, 2014 and December 31, 2013, 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 interim condensed 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 consolidated 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 senior 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.

General and Professional Liability Lawsuits and Insurance

The senior care industry has experienced 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, 2014, we and/or our managed centers are currently defendants in 33 such claims covering the years 2005 through March 31, 2014.

In 2002, due to the unavailability and/or prohibitive cost of third–party professional liability insurance coverage, we established and capitalized a wholly–owned licensed liability insurance company incorporated in the Cayman Island, for the purpose of managing our losses related to these risks. 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.

Insurance coverage for all years includes both primary policies and excess policies. Beginning in 2003, both primary and excess coverage is provided through our wholly–owned insurance company. The primary coverage is in the amount of $1.0 million per incident, $3.0 million per location with an annual primary policy aggregate limit that is adjusted on an annual basis. The excess coverage is $7.5 million annual excess in the aggregate applicable to years 2005–2007, $9.0 million annual excess in the aggregate for years 2008–2010 and $4.0 million excess per occurrence for 2011–2014.

Beginning in 2008 and continuing through March 31, 2014, additional insurance is purchased through third party providers that serve to supplement the coverage provided through our wholly–owned captive insurance company.

Other Matters

On December 19, 2013, the Company was served with a civil investigative demand from the U.S. Department of Justice and the Office of the U.S. Attorney for the Eastern District of Tennessee requesting the production of documents and interrogatory responses regarding the billing and medical necessity of certain rehabilitative therapy services. Based upon our review, the request appears to relate to services provided at our facilities based in Knoxville, Tennessee. We are cooperating fully with these requests. Because we are in the early stages of this investigation, we are unable to evaluate the outcome of this investigation.

There is certain additional litigation incidental to our business, none of which, based upon information available to date, would be material to our financial position, results of operations, or cash flows. In addition, the long-term care industry is continuously subject to scrutiny by governmental regulators, which could result in litigation or claims related to regulatory compliance matters.

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 senior health care services. We operate or manage, through certain affiliates, 73 skilled nursing facilities with 9,410 beds in nine states and provide other senior health care services in one additional state. These operations are provided by separately funded and maintained subsidiaries. We provide health care services to patients in a variety of settings including skilled nursing centers, managed care specialty units, sub–acute care units, Alzheimer's care units, homecare programs, assisted living centers and independent living centers. We also have a non-controlling ownership interest in a hospice care business that services NHC owned health care centers and others. In addition, we provide insurance services, management and accounting services, and lease properties to operators of skilled nursing health care centers.

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.

Medicare Reimbursement Rate Changes

On April 1, 2013, the automatic 2% cuts (known as "sequestration") began for Medicare providers and these cuts are expected to continue for the 2014 year. We anticipate that, assuming other factors remain constant, the resulting decrease in net patient revenues on our 2014 consolidated statement of income to range from approximately $4,000,000 to $4,500,000 for the remaining nine months of the 2014 calendar year. We are unable to predict the financial impact of other cuts Congress may implement. However, such impact may be adverse and material to our future results of operations and cash flows.

In July 2013, CMS released its skilled nursing facility PPS update for the fiscal year 2014, which began October 1, 2013. The notice provided for a 1.3% rate update, which reflects a 2.3% market basket increase less a 0.5% multifactor productivity adjustment and a 0.5% adjustment to correct market basket forecasting errors in fiscal year 2012. CMS estimates the update will increase overall payments to skilled nursing facilities in fiscal year 2014 by $470 million compared to fiscal year 2013 levels. The effect of the 2014 PPS rate update on our revenues will be dependent upon our census and the mix of our patients at the PPS pay rates.

Development and Growth

We are undertaking to expand our senior care operations while protecting our existing operations and markets. The following table lists our recent construction and purchase activities.

Type of Operation	Description	Size	Location	Placed in Service
SNF	Acquisition	106	Columbia, TN	September, 2013
SNF	Acquisition	92	Columbia, TN	September, 2013
SNF	Acquisition	139	Knoxville, TN	September, 2013
SNF	Acquisition	107	Springfield, TN	September, 2013
SNF	Acquisition	94	Madisonville, KY	September, 2013
SNF	Acquisition	112	Rossville, GA	September, 2013
SNF	New Facility	90 beds	Tullahoma, TN	October, 2013
SNF	Addition	50 beds	Lexington, SC	December, 2013
SNF	New Facility	92 beds	Sumner County, TN	Under construction
Assisted Living	New Facility	60 Units	Sumner County, TN	Under construction
Assisted Living	New Facility	85 Units	Augusta, GA	Under construction
SNF	New Facility	52 beds	Kingsport, TN	Under construction

During the first quarter of 2014, we began leasing and operating three healthcare facilities in the state of Missouri: a 120-bed skilled nursing facility and 52-unit assisted living facility in Independence, Missouri; a 70-bed memory care facility in Independence, Missouri; and a 130-bed skilled nursing facility and 52-unit assisted living facility in St. Peters, Missouri. We also assumed management of a 121-bed skilled nursing facility in Des Peres, Missouri.

We entered into a partnership with Reliant Healthcare, LLC to develop and operate a 14-bed psychiatric hospital focusing on geriatric care in Osage Beach, Missouri. This project is projected to open in the second quarter of 2014.

We anticipate starting construction on a 90-bed skilled nursing facility and an 80-unit assisted living community in Nashville, Tennessee during the third quarter of 2014.

In 2013, we applied for a CON that would be used to build a replacement center (SNF) that would combine the 92 beds of NHC Hillview in Columbia, Tennessee with 20 beds from the existing skilled nursing unit at Maury Regional Medical Center. The resulting replacement center would be a partnership between NHC and Maury Regional Medical Center. Construction is projected to begin in the fourth quarter of 2014.

Construction on both an 80-unit assisted living community in Garden City, South Carolina and a 76-unit assisted living community in Bluffton, South Carolina are scheduled to begin in the fourth quarter of 2014.

During 2014 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 assisted living communities.

Accrued Risk Reserves

Our accrued professional liability reserves, workers' compensation reserves and health insurance reserves totaled $112,304,000 at March 31, 2014 and are a primary area of management focus. We have set aside restricted cash and cash equivalents and marketable securities to fund all of our estimated professional liability and workers' compensation liabilities.

As to exposure for professional liability claims, we have developed 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

There were no significant changes during the three month period ended March 31, 2014 to the items we disclosed as our critical accounting policies and estimates in our discussion and analysis of financial condition and results of operations in our December 31, 2013 Annual Report on Form 10–K filed with the SEC.

Government Program Financial Changes

Federal Health Care Reform

In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act ("PPACA" or, commonly, "ACA") and the Health Care and Education Reconciliation Act of 2010 ("HCERA"), which represents significant changes to the current U.S. health care system (collectively the "Acts"). The primary goals of the Acts are to: (1) expand coverage to Americans without health insurance, (2) reform the delivery system to improve quality and drive efficiency, (3) and to lower the overall costs of providing health care. The timeline of the enacted provisions span over several years – some of the provisions were effective immediately in 2010 and others will be phased in through 2020.

The U.S. Supreme Court has since issued its ruling on the constitutionality of a key provision in the ACA, which is the requirement that every American maintain a minimum level of health coverage or pay a penalty beginning in 2014. The Supreme Court upheld the constitutionality of the "individual mandate", holding that the penalty for not doing so could reasonably be interpreted as a tax, which the Constitution permits. The ruling also permitted the federal government to pursue a broad expansion of the Medicaid program, but the ruling gives the states the maximum flexibility on whether to do so. With Medicaid coverage expansion, the current Administration could release a host of regulations and an array of new taxes and fees. It is uncertain at this time the effect the Acts, their modifications, or Medicaid expansion will have on our future results of operations or cash flows.

Medicare – Skilled Nursing Facilities

On April 1, 2013, the automatic 2% Medicare cuts began for skilled nursing facility providers and these cuts are expected to continue for the 2014 year. The resulting decrease in revenue to our skilled nursing facilities is approximately $3,000,000 to $3,500,000 for the remaining nine months of the 2014 calendar year.

In July 2013, CMS released its skilled nursing facility PPS update for the fiscal year 2014, which began October 1, 2013. The notice provided for a 1.3% rate update, which reflects a 2.3% market basket increase less a 0.5% multifactor productivity adjustment and a 0.5% adjustment to correct market basket forecasting errors in fiscal year 2012. CMS estimates the update will increase overall payments to skilled nursing facilities in fiscal year 2014 by $470 million compared to fiscal year 2013 levels. The effect of the 2014 PPS rate update on our revenues will be dependent upon our census and the mix of our patients at the PPS pay rates.

For the first three months of 2014, our average Medicare per diem rate for skilled nursing facilities increased 0.8% compared to the same period in 2013.

Medicaid – Skilled Nursing Facilities

Effective July 1, 2013 and for the fiscal year 2014, the state of Tennessee implemented specific individual nursing facility rate increases. We estimate the resulting increase in revenue beginning July 1, 2013 will be approximately $1,800,000 annually, or $450,000 per quarter.

Effective October 1, 2013 and for the fiscal year 2014, South Carolina implemented specific individual nursing facility rate increases. We estimate the resulting increase in revenue beginning October 1, 2013 will be approximately $1,540,000 annually, or $385,000.

During the first quarter of 2014, the state of Missouri paid a retroactive rate increase back to July 1, 2013. In 2014, the Company recorded approximately $533,000 in additional revenues for the July 1, 2013 through December 31, 2013 retroactive period and we estimate the resulting increase in revenue will be approximately $250,000 per quarter for the 2014 year.

For the first three months of 2014, our average Medicaid per diem increased 2.4% compared to same period in 2013. We face challenges with respect to states' Medicaid payments, because many currently do not cover the total costs incurred in providing care to those patients. States will continue to control Medicaid expenditures and also look for adequate funding sources, including provider assessments. There are several pieces of legislation that include provisions designed to reduce Medicaid spending. These provisions include, among others, provisions strengthening the Medicaid asset transfer restrictions for persons seeking to qualify for Medicaid long-term care coverage, which could, due to the timing of the penalty period, increase facilities' exposure to uncompensated care. Other provisions could increase state funding for home and community-based services, potentially having an impact on funding for nursing facilities.

Medicare – Homecare Programs

On November 22, 2013, CMS issued the final rule for 2014 home health prospective payment system rates, which included (i) a market basket increase of 2.3 percent, (ii) rebasing of Medicare reimbursement rates, with annual reductions of 3.5 percent for each of the next four years beginning January 2014, (iii) changes in the Wage Index with no overall impact and (iv) rebasing all case mix weights to 1.0 from an average case mix weight of 1.3464 in 2013, as provided for under the Affordable Care Act. The rule also provided for changes in low utilization payments amounts and the removal of 170 diagnosis codes, among other changes. In total, CMS predicts that home health agencies will experience an approximate 1.05 percent reduction in reimbursement for 2014.

On April 1, 2013, the automatic 2% Medicare cuts began for homecare providers and these cuts are expected to continue for the 2014 year. The resulting decrease in revenue to our homecare programs is approximately $1,000,000 for the remaining nine months of the 2014 calendar year.

Results of Operations

Three Months Ended March 31, 2014 Compared to Three Months Ended March 31, 2013

Results for the three month period ended March 31, 2014 include an 8.3% increase in net operating revenues, a 6.2% increase in income before non-operating income, and a 4.7% decrease in income before income taxes compared to the same period in 2013.

The total census at owned and leased skilled nursing facilities for the quarter averaged 89.2% compared to an average of 89.7% for the same quarter a year ago.

Medicare per diem rates at our owned and leased skilled nursing facilities increased 0.8% while managed care per diem rates decreased 4.1%, compared to the quarter a year ago. Medicaid and private pay per diem rates at our owned and leased skilled nursing facilities increased 2.4% and 7.5%, respectively, compared to the quarter a year ago.

Net patient revenues increased $21,339,000 or 12.0% compared to the same period last year. The majority of the increase in net patient revenues consist of the eleven newly operated skilled nursing facilities compared to the quarter a year ago (four in Massachusetts, three in New Hampshire, three in Missouri, and one in Tennessee). These newly operated facilities helped increase net patient revenues $19,905,000.

Other revenues decreased $5,186,000 or 32.5% in the three month 2014 period to $10,762,000 from $15,948,000 in the 2013 three–month period. The decrease in other revenues is primarily due to the decreased collection of management fees and insurance service revenue ($2,976,000) from the discontinuation of our relationship with the SeniorTrust and ElderTrust non-profit organizations. We discontinued providing management and insurance services in the first and second quarters of 2013 for SeniorTrust and in the third quarter of 2013 for ElderTrust. In the quarter a year ago, there was also a positive insurance settlement reached with one of the states in which we provide workers' compensation insurance. The 2013 event helped increase other revenues $2,268,000 in comparison to the current year quarter.

Total costs and expenses for the 2014 first quarter compared to the 2013 first quarter increased $15,161,000 or 8.5% to $193,543,000 from $178,382,000. Salaries, wages and benefits, the largest operating costs of our company, increased $12,662,000 to $119,725,000 from $107,063,000. Other operating expenses increased $1,331,000 or 2.4% to $55,742,000 for the 2014 period compared to $54,411,000 for the 2013 period. Facility rent expense increased $18,000 or 0.2% to $9,886,000. Depreciation and amortization increased 13.6% to $7,900,000.

The increase in salaries, wages and benefits is primarily due to the new operations of the eleven skilled nursing facilities compared to the quarter a year ago ($12,092,000). We also had increased costs for therapist services of $562,000 and inflationary wage increases for our partners.

The increase in other operating expenses is primarily due to the new operations of the eleven skilled nursing facilities compared to the quarter a year ago ($6,746,000). In the first quarter of 2013, we incurred additional operating expenses in the amount of $4,500,000 due to the settlement of the SeniorTrust/ElderTrust lawsuit. Therefore, this additional settlement charge in the prior period offsets the increases from the new operations when comparing the current and prior period quarters.

Non–operating income decreased by $2,046,000 to $4,572,000 in the three month 2014 period in comparison to $6,618,000 for the three month 2013 period, as further detailed in Note 4 to our interim condensed consolidated financial statements. The decrease is primarily due to our equity method investment in Caris, which decreased $1,740,000 in comparison to the quarter a year ago.

The income tax provision for the three months ended March 31, 2014 is $8,331,000 (an effective income tax rate of 38.6%). The income tax provision and effective tax rate for the three months ended March 31, 2014 were unfavorably impacted by adjustments to unrecognized tax benefits of $189,000 and permanent differences including nondeductible expenses of $27,000 resulting in an increase in the provision. The income tax provision for the three months ended

March 31, 2013 was $8,809,000 (an effective income tax rate of 39.0%). The income tax provision and effective tax rate for the three months ended March 31, 2013 were unfavorably impacted by adjustments to unrecognized tax benefits of $153,000 and permanent differences including nondeductible expenses of $30,000 resulting in an increase in the provision.

Liquidity, Capital Resources, and Financial Condition

Our primary sources of cash include revenues from the operations of our healthcare and senior living facilities, insurance services, management services and accounting services. Our primary uses of cash include salaries, wages and other operating costs of our healthcare and senior living facilities, the cost of additions to and acquisitions of real property, facility rent expenses, and dividend distributions. These sources and uses of cash are reflected in our interim condensed 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 March 31		Three Month Change	
	2014	2013	$	%
Cash and cash equivalents at beginning of period	$ 81,705	$ 66,701	$ 15,004	22.5%
Cash provided by operating activities	15,148	24,848	(9,700)	(39.0)%
Cash used in investing activities	(12,160)	(6,798)	(5,362)	(78.9)%
Cash used in financing activities	(556)	(10,912)	10,356	94.9%
Cash and cash equivalents at end of period	$ 84,137	$ 73,839	$ 10,298	13.9%

Operating Activities

Net cash provided by operating activities for the three months ended March 31, 2014 was $15,148,000, as compared to $24,848,000 in the same period last year. Cash provided by operating activities consisted of net income of $13,229,000, adjustments for non–cash items of $11,285,000, and $9,366,000 used for working capital.

Cash used for working capital primarily consisted of a decrease in accrued payroll ($22,783,000) and was offset by an increase in other current liabilities ($6,376,000) and accounts payable ($4,923,000). The majority of the decrease in accrued payroll is due to the timing and payments of incentive compensation related to the 2013 year. The increase in other current liabilities is primarily related to timing of quarterly federal income tax payments.

Investing Activities

Cash used in investing activities totaled $12,160,000 and $6,798,000 for the three months ended March 31, 2014 and 2013, respectively. Cash used for property and equipment additions was $9,271,000 for the three months ended March 31, 2014 and $6,366,000 in the comparable period in 2013. In 2014, the Company made investments in unconsolidated partnerships in the amount of $706,000 for projects under development and a note receivable was advanced in the amount of $767,000 to a third party operator in which we provide accounting services. Purchases and sales of restricted marketable securities resulted in a net use of cash of $1,448,000 for the 2014 period compared to $826,000 for the 2013 period.

Construction costs included in additions to property and equipment in 2014 include $2,604,000 for the continued construction of the 92-bed skilled nursing facility and 60-unit assisted living facility in Gallatin, Tennessee, $1,153,000 for the 14-bed psychiatric hospital focusing on geriatric care in Osage Beach, Missouri, and $480,000 for the continued renovation of a 52-bed transitional care center in Kingsport, Tennessee.

Financing Activities

Net cash used in financing activities totaled $556,000 and $10,912,000 for the three months ended March 31, 2014 and 2013, respectively. Cash used for dividend payments to common and preferred stockholders totaled $6,664,000 in the current year period compared to $6,404,000 for the same period a year ago. In the current period, $6,476,000 was provided by the issuance of common stock. In the prior year period, $4,700,000 was used to purchase 100,000 shares of common stock under our stock repurchase program.

Table of Contractual Cash Obligations

Our contractual cash obligations for periods subsequent to March 31, 2014 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	1,035	276	552	207	–
Operating leases	441,800	34,200	68,400	68,400	270,800
Construction obligations	20,796	20,796	–	–	–
Capital lease obligations	51,567	5,200	10,400	10,400	25,567
Total contractual cash obligations	$ 525,198	$ 60,472	$ 79,352	$ 89,007	$ 296,367

Other noncurrent liabilities for uncertain tax positions of $4,200,000, attributable to permanent differences, at March 31, 2014 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 14 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

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 $84,137,000 at March 31, 2014, marketable securities of $113,461,000 at March 31, 2014 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. We currently do not have any funds drawn against our revolving credit agreement and the amount of $75,000,000 is available to be drawn for general corporate purposes, including working capital and acquisitions.

Long–term liquidity

Our $75,000,000 revolving credit agreement matures on October 22, 2014. 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 renewal, there has been no commitment at this time. We entered into this loan originally on October 30, 2007, and have renewed the loan six 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.

Commitment and Contingencies

Civil Investigative Demand

On December 19, 2013, the Company was served with a civil investigative demand from the U.S. Department of Justice and the Office of the U.S. Attorney for the Eastern District of Tennessee requesting the production of documents and interrogatory responses regarding the billing and medical necessity of certain rehabilitative therapy services. Based upon our review, the request appears to relate to services provided at our facilities based in Knoxville, Tennessee. We are cooperating fully with these requests. Because we are in the early stages of this investigation, we are unable to evaluate the outcome of this investigation.

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.

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.

Inflation

We have historically derived a substantial portion of our revenue from the Medicare and Medicaid programs, along with similar reimbursement programs. Payments under these programs generally provide for reimbursement levels that are adjusted for inflation annually based upon the state's fiscal year for the Medicaid programs and in each October for the Medicare program. The adjustments may not continue in the future, and even if received, such adjustments may not reflect the actual increase in our costs for providing healthcare services.

New Accounting Pronouncements

See Note 2 to the Interim Condensed Consolidated Financial Statements for the impact of new accounting standards.

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 on 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 expression 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:

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

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

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

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liabilities and other claims asserted against us, including patient care liabilities, as well as the resolution of current litigation (see Note 15: Guarantees and Contingencies);

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

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- the ability to attract and retain qualified personnel;
- the availability and terms of capital to fund acquisitions and capital improvements;
- the ability to refinance existing debt on favorable terms;
- the competitive environment in which we operate;
- the ability to maintain and increase census levels; and
- demographic changes.

See the notes to the quarterly financial statements, and "Item 1. Business" in our 2013 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. You should carefully consider these risks before making any investment in the Company. These risks and uncertainties are not 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, 2014, we have available for sale debt securities in the amount of $140,078,000. 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, 2014, 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 $75.0 million and our outstanding long–term debt, a 1% change in interest rates would change our annual interest cost by approximately $850,000.

Approximately $4.8 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 $48,000.

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.

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, 2014, the fair value of our equity marketable securities is approximately $113,461,000. Of the $113.5 million equity securities portfolio, our investment in National Health Investors, Inc. ("NHI") comprises approximately $98.5 million, or 86.8%, 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 $11.3 million. At March 31, 2014, our equity securities had unrealized gains of $83.2 million. Of the $83.2 million of unrealized gains, $73.9 million is related to our investment in NHI.

Item 4. Controls and Procedures.

As of March 31, 2014, 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, 2014. There have been no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2014 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 15 of this Form 10–Q.

Item 1A. Risk Factors.

During the three months ended March 31, 2014, 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, 2013.

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

Item 6. Exhibits.

(a)

List of exhibits

EXHIBIT INDEX

Exhibit No.	Description	Page No. or Location
3.1	Certificate of Incorporation of National HealthCare Corporation	Incorporated by reference to Exhibit 3.1 to the Registrant's registration statement on Form S-4 (File No. 333-37185) dated October 3, 1997)
3.2	Certificate of Amendment to the Certificate of Incorporation of National HealthCare Corporation	Incorporated by reference to Exhibit 3.2 to the Registrant's registration statement on Form 8-A, dated October 31, 2007)
3.3	Certificate of Designations of Series A Convertible Preferred Stock of National HealthCare Corporation	Incorporated by reference to Exhibit 2.1 to the current report on Form 8-K filed on December 20, 2006
3.4	Certificate of Designation Series B Junior Participating Preferred Stock	Incorporated by reference to Exhibit 3.1 to the Registrant's registration statement on Form 8-A, dated August 3, 2007
3.5	Restated Bylaws as amended February 14, 2013	Specifically incorporated by reference to Exhibit 3.5 to the quarterly report on Form 10-Q filed on May 8, 2013.
4.1	Form of Common Stock	Specifically incorporated by reference to Exhibit A attached to Form S-4, (Proxy Statement- Prospectus), amended, Registration No. 333-

		37185, (December 5, 1997)
4.2	Form of Series A Convertible Preferred Stock Certificate	Incorporated by reference to Exhibit A to Exhibit 3.5 to the Registrant's registration statement on Form 8-A, dated October 31, 2007)
4.3	Rights Agreement, dated as of August 2, 2007, between National HealthCare Corporation and Computershare Trust Company, N.A.	Incorporated by reference to Exhibit 4.1 to the Registrant's registration statement on Form 8-A, dated August 3, 2007
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	Filed Herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Accounting Officer	Filed Herewith
32	Certification pursuant to 18 U.S.C. Section 1350 by Chief Executive Officer and Principal Accounting Officer	Filed Herewith
*101.INS	XBRL Instance Document	
*101.SCH	XBRL Taxonomy Extension Schema Document	
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document	
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	

* As provided in Rule 406T of Regulation S-T, this information shall not be deemed “filed” for purposes of Sections 11 and 12 of the Securities Act and Section 18 of the Securities Exchange Act or otherwise subject to liability under those sections.

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, 2014

/s/ Robert G. Adams

Robert G. Adams
Chief Executive Officer

Date: May 9, 2014

/s/ Donald K. Daniel

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