NATIONAL HEALTHCARE CORP
Form 10-Q
May 07, 2010

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

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 S No. £

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

Yes £ No £

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

Large Accelerated filer £	Accelerated filer S
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 S

13,748,365 shares of common stock of the registrant were outstanding as of April 28, 2010.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Statements of Income

(Unaudited)

(in thousands, except share and per share amounts)

	Three Months Ended March 31	
	2010	2009
Revenues:		
Net patient revenues	$ 157,961	$ 153,067
Other revenues	14,076	11,622
Net revenues	172,037	164,689
Costs and Expenses:		
Salaries, wages and benefits	96,076	90,726
Other operating	49,003	47,968
Rent	8,178	7,968
Depreciation and amortization	6,427	6,243
Interest	114	207
Total costs and expenses	159,798	153,112
Income Before Non-Operating Income	12,239	11,577
Non-Operating Income	4,575	3,980
Income Before Income Taxes	16,814	15,557
Income Tax Provision	(6,407)	(6,373)

Net Income		10,407		9,184
Dividends to Preferred Stockholders		(2,168)		(2,168)
Net Income Available to Common Stockholders	$	8,239	$	7,016
Earnings Per Common Share:				
Basic	$	.60	$	.53
Diluted	$	.60	$	.53
Weighted Average Common Shares Outstanding:				
Basic		13,721,570		13,228,845
Diluted		13,725,201		13,254,437

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, 2010	December 31 2009
	(unaudited)	
Assets		
Current Assets:		
Cash and cash equivalents	$ 27,789	$ 39,022
Restricted cash and cash equivalents	55,515	96,934
Marketable securities	74,358	71,280
Restricted marketable securities	66,514	19,350
Accounts receivable, less allowance for doubtful accounts of $4,009 and $3,502, respectively	67,915	62,129
Inventories	7,641	7,393
Prepaid expenses and other assets	2,679	1,074
Federal income tax receivable		3,470
Total current assets	302,411	300,652
Property and Equipment:		
Property and equipment, at cost	613,703	608,753
Accumulated depreciation and amortization	(187,856)	(181,177)
Net property and equipment	425,847	427,576
Other Assets:		
Deposits	415	323
Goodwill	5,978	5,978

Notes receivable	26,257	26,805
Deferred income taxes	16,106	15,555
Investments in limited liability companies and other	12,900	11,643
Total other assets	61,656	60,304
Total assets	$ 789,914	$ 788,532

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

The interim condensed consolidated balance sheet at December 31, 2009 is taken from the audited consolidated financial statements at that date.

NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Balance Sheets

(in thousands, except share and per share amounts)

	March 31, 2010 (unaudited)	December 31, 2009
Liabilities and Stockholders Equity		
Current Liabilities:		
Trade accounts payable	$ 11,986	$ 10,909
Accrued payroll	30,523	46,149
Amounts due to third party payors	19,520	18,617
Accrued risk reserves	110,821	107,456
Deferred income taxes	9,347	8,427
Other current liabilities	15,154	15,117
Dividends payable	5,740	5,729
Accrued interest	10	81
Total current liabilities	203,101	212,485
Long-Term Debt, less Current Portion	10,000	10,000
Other Noncurrent Liabilities	23,139	22,633
Deferred Lease Credits	2,120	2,423
Deferred Revenue	18,310	15,212
Commitments, Contingencies and Guarantees		
Stockholders Equity:		
Series A Convertible Preferred Stock; $.01 par value; 25,000,000 shares authorized; 10,841,062 shares issued and outstanding; stated at liquidation of $15.75 per share	170,555	170,555
Common stock, $.01 par value; 30,000,000 shares authorized; 13,737,679 and 13,717,701 shares, respectively, issued and outstanding	137	137

Capital in excess of par value		131,566		130,867
Retained earnings		201,807		197,140
Unrealized gains on marketable securities, net of taxes		29,179		27,080
Total stockholders equity		533,244		525,779
Total liabilities and stockholders equity	$	789,914	$	788,532

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

The interim condensed consolidated balance sheet at December 31, 2009 is taken from the audited consolidated financial statements at that date.

NATIONAL HEALTHCARE CORPORATION

Interim Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended	
	March 31	
	2010	2009
Cash Flows From Operating Activities:	*(in thousands)*	
Net income	$ 10,407	$ 9,184
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,427	6,243
Provision for doubtful accounts receivable	507	170
Amortization of deferred charges	(33)	(68)
Equity in earnings of unconsolidated investments	(2,258)	(2,003)
Distributions from unconsolidated investments	1,024	67
Deferred income taxes	(950)	(1,142)
Stock-based compensation	24	339
Changes in operating assets and liabilities:		
Restricted cash and cash equivalents	(5,407)	(550)
Accounts (and other) receivable	(6,293)	3,001
Income tax receivable	3,470	
Inventories	(248)	358
Prepaid expenses and other assets	(1,605)	(1,124)
Trade accounts payable	1,077	2,531
Accrued payroll	(15,626)	(17,920)
Amounts due to third party payors	903	68
Accrued interest	(71)	(28)
Other current liabilities and accrued risk reserves	3,402	2,028
Entrance fee deposits	(201)	(254)
Other noncurrent liabilities	506	93
Deferred income	3,332	3,485
Net cash (used in) provided by operating activities	(1,613)	4,478
Cash Flows From Investing Activities:		
Additions to and acquisitions of property and equipment	(5,001)	(9,456)

Investments in notes receivable		(11)
Collections of notes receivable	548	3,166
Decrease in restricted cash and cash equivalents	46,826	
Purchase of restricted marketable securities	(52,699)	
Sale of restricted marketable securities	5,875	
Changes in cash fund in liquidation		2,186
Net cash used in investing activities	(4,451)	(4,115)
Cash Flows From Financing Activities:		
Payments on debt		(1)
Tax benefit from exercise of stock options	13	3,499
Dividends paid to preferred stockholders	(2,168)	(2,168)
Dividends paid to common stockholders	(3,561)	(3,123)
Issuance of common shares	662	13,091
Decrease (increase) in deposits	(92)	342
Other	(23)	(418)
Net cash (used in) provided by financing activities	(5,169)	11,222
Net (Decrease) Increase in Cash and Cash Equivalents	(11,233)	11,585
Cash and Cash Equivalents, Beginning of Period	39,022	49,033
Cash and Cash Equivalents, End of Period	$ 27,789	$ 60,618

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	Unrealized Gains (Losses) on Marketable Securities	Total Stockholders Equity
	Shares	Amount	Shares	Amount				
Balance at December 31, 2008	10,841,062	$ 170,555	13,031,696	$ 130	$ 113,580	$ 179,710	$ 16,842	$ 480,817
Net income						9,184		9,184
Unrealized losses on securities (net of tax of $1,370)							(2,057)	(2,057)
Total comprehensive income								7,127
Stock-based compensation					339			339
Tax benefit from exercise of stock options					1,575			1,575
Shares sold - options exercised			615,204	6	13,085			13,091
Dividends declared						(2,168)		(2,168)

to preferred stockholders ($0.20 per share)								
Dividends declared to common stockholders ($0.24 per share)						(3,275)		(3,275)
Balance at March 31, 2009	10,841,062	$ 170,555	13,646,900	$ 136	$ 128,579	$ 183,451	$ 14,785	$ 497,506
Balance at December 31, 2009	10,841,062	$ 170,555	13,717,701	$ 137	$ 130,867	$ 197,140	$ 27,080	$ 525,779
Net income						10,407		10,407
Unrealized gains on securities (net of tax of $1,319)							2,099	2,099
Total comprehensive income								12,506
Stock-based compensation					24			24
Tax benefit from exercise of stock options					13			13
Shares sold options exercised			19,978		662			662
Dividends declared to						(2,168)		(2,168)

preferred stockholders ($0.20 per share)								
Dividends declared to common stockholders ($0.26 per share)						(3,572)		(3,572)
Balance at March 31, 2010	10,841,062	$ 170,555	13,737,679	$ 137	$ 131,566	$ 201,807	$ 29,179	$ 533,244

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

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NATIONAL HEALTHCARE CORPORATION

March 31, 2010

(unaudited)

Note 1 Consolidated Financial Statements

The unaudited condensed consolidated financial statements to which these notes are attached include, in our opinion, all normal, recurring adjustments which are necessary to fairly present the financial position, results of operations and cash flows of National HealthCare Corporation (NHC@ or the Company). We assume that users of these interim financial statements have read or have access to the audited December 31, 2009 consolidated financial statements and Management=s Discussion and Analysis of Financial Condition and Results of Operations and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies, may be determined in that context. Accordingly, footnotes and other disclosures which would substantially duplicate the disclosure contained in our most recent annual report to stockholders have been omitted. This interim financial information is not necessarily indicative of the results that may be expected for a full year for a variety of reasons. Our audited December 31, 2009 consolidated financial statements are available at our web site: www.nhccare.com.

Reclassifications

The 2010 and 2009 financial information has been reclassified so the basis of presentation is consistent with that of the 2010 financial information. Specifically, the Company reclassified non-operating income out of other revenues in the Consolidated Statements of Income.

Note 2 Other Revenues

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

Other revenues include the following:

	Three Months Ended March 31	
(in thousands)	2010	2009
Insurance services	$ 4,389	$ 4,276
Management and accounting services fees	6,207	3,862
Rental income	3,049	3,096
Other	431	388
	$ 14,076	$ 11,622

Certain of our affiliates manage five long-term care centers owned by National Health Corporation (National). During the three months ended March 31, 2010 and 2009, we recognized management fees and interest on management fees of $1,446,000 and $-0-, respectively.

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

Certain of our affiliates manage 15 long-term care centers that were previously owned by National Health Investors, Inc. (NHI). During the three months ended March 31, 2010 and 2009, we recognized $1,257,000 and $738,000, respectively, of management fees and interest from these 15 long-term care centers.

Of the total 15 centers managed, the management fee revenues from seven centers were currently paid and recognized on the accrual method in 2010 and 2009. The fees from the remaining eight centers, because of insufficient historical collections and the lack of expected future collections, are recognized only when realized. Under the terms of the management agreements, the payment of these fees to us may be subordinated to other expenditures of each of the long-term care centers. Our affiliates continue to manage these centers so that we may be able to collect our fees in the future and because the incremental savings from discontinuing services to a center may be small compared to the potential benefit. We may receive payment for the unrecognized management fees in whole or in part in the future only if cash flows from operating and investing activities of the centers are sufficient to pay the fees. There can be no assurance that such future improved cash flows will occur.

Note 3 - Non-Operating Income

Non-operating income is outlined in the table below. Non-operating income includes dividends and other realized gains and losses on securities, interest income and equity in earnings of unconsolidated investments. Our most significant equity method investment is a 50% ownership and voting interest in Caris HealthCare L.P., a business that specializes in hospice care services.

	Three Months Ended

	March 31	
	2010	2009
(in thousands)		
Equity in earnings of unconsolidated investments	$ 2,258	$ 2,003
Dividends and other net realized gains and losses on sales of securities	1,140	1,062
Interest income	1,177	915
	$ 4,575	$ 3,980

Note 4 Other Operating Expenses

Other operating expenses include the costs of care and services that we provide to the residents of our facilities and the costs of maintaining our facilities. Our primary patient care costs include drugs, medical supplies, purchased professional services, food, professional insurance and licensing fees. The primary facility costs include utilities and property insurance.

Note 5 Earnings per Share

We compute earnings per share using the two-class method. Under the two-class method, earnings per common share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period.

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.

	Three Months Ended March 31	
(in thousands, except for share and per share amounts)	2010	2009
Basic:		
Weighted average common shares outstanding	13,721,570	13,228,845
Net income	$ 10,407	$ 9,184
Dividends to preferred stockholders	2,168	2,168
Net income available to common stockholders	8,239	7,016
Earnings per common share, basic	$ .60	$ .53
Diluted:		
Weighted average common shares outstanding	13,721,570	13,228,845
Dilutive effect of stock options	3,631	25,592
Assumed average common shares outstanding	13,725,201	13,254,437
Net income available to common stockholders	$ 8,239	$ 7,016
Net income for diluted earnings per common share	8,239	7,016
Earnings per common share, diluted	$ .60	$ .53

In the above table, 356,791 shares and 269,245 shares of stock options have been excluded in the 2010 and 2009 three month periods, respectively and 2,623,971 of preferred stock potential common shares issuable upon the conversion of the preferred stock have been excluded for 2010 and 2009, due to their anti-dilutive impact.

Note 6 - Investments in Marketable Securities

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

Marketable securities and restricted marketable securities consist of the following:

	March 31, 2010		December 31, 2009	
	Amortized	Fair	Amortized	Fair
(in thousands)	Cost	Value	Cost	Value
Investments available for sale:				
Marketable equity securities	$ 29,604	$ 74,358	$ 29,604	$ 71,280
Restricted investments available for sale:				
Corporate debt securities	28,739	28,745	3,159	3,125
Commercial mortgage-backed securities	20,144	20,365	7,422	7,392
U.S. Treasury securities	10,760	10,701	8,918	8,833
U.S. government sponsored enterprise securities	5,379	5,396		
State and municipal securities	1,301	1,307		
	$ 95,927	$ 140,872	$ 49,103	$ 90,630

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

(in thousands, except share amounts)

	March 31, 2010			December 31, 2009		
	Shares	Cost	Fair Value	Shares	Cost	Fair Value
NHI Common Stock	1,630,642	$ 24,734	$ 63,204	1,630,642	$ 24,734	$ 60,317

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

	March 31, 2010		December 31, 2009	
(in thousands)	Cost	Fair Value	Cost	Fair Value
Maturities:				
Within 1 year	$ 375	$ 378	$ 1,475	$ 1,493
1 to 5 years	33,907	33,891	13,105	12,984
6 to 10 years	14,000	14,015	4,919	4,873
Over 10 years	18,041	18,230		
	$ 66,323	$ 66,514	$ 19,499	$ 19,350

Gross unrealized gains related to available for sale securities are $44,987,000 and $41,676,000 as of March 31, 2010 and December 31, 2009, respectively. Gross unrealized losses related to available for sale securities were $42,000 and $149,000 as of March 31, 2010 and December 31, 2009, respectively.

Proceeds from the sale of investments in marketable securities during the periods ended March 31, 2010 and March 31, 2009 were $5,875,000, and $-0-, respectively. Gross investment gains of $38,000 were realized on these sales during the period ended March 31, 2010.

Note 7 - Fair Value Measurements

The carrying amounts of cash and cash equivalents, restricted cash, accounts receivable, and accounts payable approximate fair value due to their short-term nature. The estimated fair value of notes receivable approximates the carrying value based principally on their underlying interest rates and terms, maturities, collateral and credit status of the receivables. Our long-term debt approximates fair value due to variable interest rates. At March 31, 2010 and December 31, 2009, there were no material differences between the carrying amounts and fair values of NHC s financial instruments.

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

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

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

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

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

The Company determines fair value for marketable securities with Level 1 inputs through quoted market prices. The Company determines fair value for marketable securities with Level 2 inputs through broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. Our Level 2 marketable securities have been initially valued at the transaction price and subsequently valued, at the end of each month, typically utilizing third party pricing services or other market observable data. The pricing services utilize industry standard valuation models, including both income and market based approaches and observable market inputs to determine value. These observable market inputs include reportable trades, benchmark yields, credit spreads, broker/dealer quotes, bids, offers, and other industry and economic events. We did not have any significant transfers of assets between Level 1 and Level 2 of the fair value measurement hierarchy during the three months ended March 31, 2010.

The following table summarizes fair value measurements by level at March 31, 2010 and December 31, 2009 for assets and liabilities measured at fair value on a recurring basis (in thousands):

		Fair Value Measurements Using		
March 31, 2010	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Restricted cash and cash equivalents	$ 43,379	$ 43,379	$	$

Marketable equity securities	74,358	74,358		
Corporate debt securities	28,745		28,745	
Commercial mortgage-backed securities	20,365		20,365	
U.S. Treasury securities	10,701	10,701		
U.S. government sponsored enterprise securities	5,396		5,396	
State and municipal securities	1,307		1,307	
Total financial assets	$ 184,251	$ 128,438	$ 55,813	$

		Fair Value Measurements Using		
December 31, 2009	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Restricted cash and cash equivalents	$ 72,301	$ 72,301	$	$
Marketable equity securities	71,280	71,280		
Corporate debt securities	3,125	3,125		
Commercial mortgage-backed securities	7,392		7,392	
U.S. Treasury securities	8,833	8,833		
Total financial assets	$ 162,931	$ 155,539	$ 7,392	$

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NATIONAL HEALTHCARE CORPORATION

March 31, 2010

(unaudited)

Note 8 - Long-Term Debt and Commitments

Long-Term Debt

Long-term debt consists of the following:

(dollars in thousands)	Weighted Average Interest Rate	Maturities	Long-Term Debt 3/31/10	12/31/09
Revolving Credit Facility, interest payable monthly	Variable, 1.24%	2010	$ -	$ -
Unsecured term note payable to National, interest payable quarterly, principal payable at maturity	Variable, 2.8%	2018	10,000	10,000
			10,000	10,000
Less current portion			-	-
			$ 10,000	$ 10,000

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

Effective October 27, 2009, we extended the maturity of our Credit Agreement (the Credit Agreement) with Bank of America, N.A., as lender (the Lender). The Credit Agreement provides for a $75,000,000 revolving credit facility (the Credit Facility), of which up to $5,000,000 may be utilized for letters of credit.

Borrowings bear interest at either (i) the Eurodollar rate plus 1.00% or (ii) the prime rate. Letter of credit fees are equal to 1.00% times the maximum amount available to be drawn under outstanding letters of credit. Prior to the extension, the borrowing bore interest at either (i) the Eurodollar rate plus 0.375% or (ii) the prime rate.

Beginning October 27, 2009, commitment fees are payable on the daily unused portion of the Credit Facility at a rate of twenty (20) basis points per annum. NHC is permitted to prepay the loans outstanding under the Credit Facility at any time, without penalty.

The Credit Facility matures on October 26, 2010. Between 90 and 120 days prior to the maturity date, NHC may request the extension of the maturity date. If the Lender elects to consent to such extension, subject to certain conditions, the maturity date will be extended to the date which is 364 days after the then maturity date.

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

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

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

NATIONAL HEALTHCARE CORPORATION

March 31, 2010

(unaudited)

Note 10 Stock Option Plans

Our stockholders approved the 2005 Stock Option, Employee Stock Purchase, Physician Stock Purchase and Stock Appreciation Rights Plan (the APlan@) which provides for the grant of stock options to key employees, directors and non employee consultants. Under the Plan, the Compensation Committee of the Board of Directors (Athe Committee@) has the authority to select the participants to be granted options; to designate whether the option granted is an incentive stock option (AISO@), a non qualified option, or a stock appreciation right; to establish the number of shares of common stock that may be issued upon exercise of the option; to establish the vesting provision for any award; and to establish the term any award may be outstanding. The exercise price of any ISO=s granted will not be less than 100% of the fair market value of the shares of common stock on the date granted and the term of an ISO may not be any more than ten years. The exercise price of any non qualified options granted will not be less than 100% of the fair market value of the shares of common stock on the date granted unless so determined by the Committee.

The Company is required to estimate the fair value of share-based awards on the date of grant. The fair value of each option award is estimated using the Black Scholes option valuation model with the weighted average assumptions indicated in the following table. Generally, awards are subject to cliff vesting. Each grant is valued as a single award with an expected term based upon expected employment and termination behavior. Compensation cost is recognized as Salaries, wages and benefits in the Consolidated Statements of Income over the requisite service period in a manner consistent with the option vesting provisions. The straight line attribution method requires that compensation expense is recognized at least equal to the portion of the grant date fair value that is vested at that date. The expected volatility is derived using weekly historical data for periods immediately preceding the date of grant. The risk free interest rate is the approximate yield on the United States Treasury Strips having a life equal to the expected option life on the date of grant. The expected life is an estimate of the number of years an option will be held before it is exercised. The following table summarizes the assumptions used to value the options granted in the periods shown.

	Three Months Ended March 31	
	2010	2009
Risk-free interest rate	0.45%	4.00%
Expected volatility	31.9%	32.9%
Expected life, in years	1.0 years	1.0 years
Expected dividend yield	3.07%	2.07%
Expected forfeiture rate	0.00%	0.00%

NATIONAL HEALTHCARE CORPORATION

March 31, 2010

(unaudited)

The following table summarizes option activity:

	Number of Shares		Weighted Average Exercise Price	Aggregate Intrinsic Value
Options outstanding at December 31, 2008	992,196	$	30.55	–
Options granted	113,914		37.37	–
Options exercised				