NATIONAL HEALTHCARE CORP
Form 10-Q
August 06, 2015

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 June 30, 2015
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]

14,251,756 shares of common stock of the registrant were outstanding as of August 4, 2015.

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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 June 30		Six Months Ended June 30	
	2015	2014	2015	2014
Revenues:				
Net patient revenues	$ 214,433	$ 205,632	$ 426,494	$ 405,401
Other revenues	10,469	10,923	20,815	21,685
Net operating revenues	224,902	216,555	447,309	427,086
Cost and Expenses:				
Salaries, wages and benefits	131,914	125,614	257,630	245,339
Other operating	57,467	55,696	117,214	111,438
Facility rent	9,981	9,913	19,966	19,799
Depreciation and amortization	9,236	8,605	18,169	16,505
Interest	598	644	1,188	934
Total costs and expenses	209,196	200,472	414,167	394,015
Income Before Non–Operating Income	15,706	16,083	33,142	33,071
Non–Operating Income	4,130	4,281	8,352	8,853
Income Before Income Taxes	19,836	20,364	41,494	41,924
Income Tax Provision	(7,478)	(7,853)	(15,894)	(16,184)
Net Income	12,358	12,511	25,600	25,740
Dividends to Preferred Stockholders	(2,167)	(2,167)	(4,335)	(4,335)
Net Income Available to Common Stockholders	$ 10,191	$ 10,344	$ 21,265	$ 21,405

Earnings Per Common Share:				
Basic	$ 0.74	$ 0.75	$ 1.54	$ 1.54
Diluted	$ 0.71	$ 0.72	$ 1.48	$ 1.50
Weighted Average Common Shares Outstanding:				
Basic	13,772,873	13,868,470	13,767,248	13,855,900
Diluted	14,381,746	14,282,785	14,336,027	14,226,887
Dividends Declared Per Common Share	$ 0.40	$ 0.34	$ 0.74	$ 0.66

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 June 30		Six Months Ended June 30	
	2015	2014	2015	2014
Net Income	$ 12,358	$ 12,511	$ 25,600	$ 25,740
Other Comprehensive Income (Loss):				
Unrealized (losses) gains on investments in marketable securities	(19,072)	5,693	(15,085)	15,291
Reclassification adjustment for realized gains on sale of securities	(80)	(36)	(421)	(172)
Income tax benefit (expense) related to items of other comprehensive income	7,379	(2,146)	6,013	(5,796)
Other comprehensive income (loss), net of tax	(11,773)	3,511	(9,493)	9,323
Comprehensive Income	$ 585	$ 16,022	$ 16,107	$ 35,063

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)

	June 30, 2015 *unaudited*	December 31, 2014
Assets		
Current Assets:		
Cash and cash equivalents	$ 71,500	$ 69,767
Restricted cash and cash equivalents	6,983	7,020
Marketable securities	117,906	132,535
Restricted marketable securities	19,605	19,805
Accounts receivable, less allowance for doubtful accounts of $6,684 and $5,738, respectively	77,957	78,843
Inventories	7,273	7,127
Prepaid expenses and other assets	2,959	2,260
Notes receivable, current portion	3,956	441
Federal income tax receivable	-	4,727
Total current assets	308,139	322,525
Property and Equipment:		
Property and equipment, at cost	844,660	821,792
Accumulated depreciation and amortization	(325,039)	(307,048)
Net property and equipment	519,621	514,744
Other Assets:		
Restricted cash and cash equivalents	3,631	3,631
Restricted marketable securities	145,868	138,468
Deposits and other assets	8,379	8,791
Goodwill	17,600	17,600
Notes receivable, less current portion	13,042	12,548
Deferred income taxes	22,269	18,700
Investments in limited liability companies	35,076	37,116
Total other assets	245,865	236,854
Total assets	$ 1,073,625	$ 1,074,123

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)

	June 30, 2015 *unaudited*	December 31, 2014
Liabilities and Stockholders' Equity		
Current Liabilities:		
Trade accounts payable	$ 17,121	$ 15,877
Capital lease obligations, current portion	3,182	3,088
Accrued payroll	49,010	59,859
Amounts due to third party payors	25,457	22,931
Accrued risk reserves, current portion	26,588	26,825
Deferred income taxes	28,193	35,506
Other current liabilities	13,552	12,472
Dividends payable	7,867	7,000
Total current liabilities	170,970	183,558
Long–term debt	10,000	10,000
Capital lease obligations, less current portion	31,893	33,508
Accrued risk reserves, less current portion	81,927	79,393
Refundable entrance fees	10,016	10,219
Obligation to provide future services	3,927	3,927
Other noncurrent liabilities	17,397	16,011
Deferred revenue	4,892	3,359
Stockholders' Equity:		
Series A Convertible Preferred Stock; $.01 par value; 25,000,000 shares authorized; 10,772,712 and 10,836,659 shares, respectively, issued and outstanding; stated at liquidation value of $15.75 per share	169,479	170,494
Common stock, $.01 par value; 30,000,000 shares authorized; 14,249,336 and 14,110,859 shares, respectively, issued and outstanding	142	140
Capital in excess of par value	163,195	154,965
Retained earnings	354,672	343,941
Accumulated other comprehensive income	55,115	64,608
Total stockholders' equity	742,603	734,148
Total liabilities and stockholders' equity	$ 1,073,625	$ 1,074,123

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)

	Six Months Ended June 30 2015	2014
Cash Flows From Operating Activities:		
Net income	$ 25,600	$ 25,740
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,169	16,505
Provision for doubtful accounts receivable	3,763	3,121
Equity in earnings of unconsolidated investments	(2,386)	(3,654)
Distributions from unconsolidated investments	4,749	9,251
Gains on sale of restricted marketable securities	(421)	(172)
Deferred income taxes	(4,869)	(4,085)
Stock–based compensation	1,132	1,170
Changes in operating assets and liabilities, net of the effect of acquisitions:		
Restricted cash and cash equivalents	(5,701)	(1,622)
Accounts receivable	(2,877)	(4,107)
Income tax receivable	4,727	(2,829)
Inventories	(146)	(33)
Prepaid expenses and other assets	(699)	(938)
Trade accounts payable	1,244	3,887
Accrued payroll	(10,849)	(20,091)
Amounts due to third party payors	2,526	1,289
Other current liabilities and accrued risk reserves	3,295	807
Other noncurrent liabilities	1,386	1,226
Deferred revenue	1,533	1,530
Net cash provided by operating activities	40,176	26,995
Cash Flows From Investing Activities:		
Additions to property and equipment	(23,046)	(22,963)
Investments in unconsolidated limited liability companies	(323)	(1,312)
Acquisition of non-controlling interest	-	(768)
Investments in notes receivable	(4,237)	(767)
Collections of notes receivable	228	2,937
Change in restricted cash and cash equivalents	5,738	364
Purchase of restricted marketable securities	(35,952)	(30,173)
Sale of restricted marketable securities	28,296	27,641
Net cash used in investing activities	(29,296)	(25,041)
Cash Flows From Financing Activities:		
Tax benefit from stock–based compensation	342	201
Principal payments under capital lease obligations	(1,521)	(960)
Dividends paid to preferred stockholders	(4,335)	(4,335)
Dividends paid to common stockholders	(9,667)	(9,078)

Issuance of common shares		5,743		6,752
Entrance fee deposits		(203)		(42)
Change in deposits		494		(439)
Net cash used in financing activities		(9,147)		(7,901)
Net Increase (Decrease) in Cash and Cash Equivalents		1,733		(5,947)
Cash and Cash Equivalents, Beginning of Period		69,767		81,705
Cash and Cash Equivalents, End of Period	$	71,500	$	75,758
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, 2014	10,837,665	$ 170,510	14,078,028	$ 140	$ 153,061	$ 318,216	$ 46,185	$ 688,112
Net income	–	–	–	–	–	25,740	–	25,740
Other comprehensive income	–	–	–	–	–	–	9,323	9,323
Stock–based compensation	–	–	–	–	1,170	–	–	1,170
Tax benefit from exercise of stock options	–	–	–	–	201	–	–	201
Shares sold – options exercised	–	–	148,974	1	6,751	–	–	6,752
Shares issued in conversion of preferred stock to common stock	(1,006)	(16)	241	–	16	–	–	–
Acquisition of non-controlling interest	–	–	–	–	(768)	–	–	(768)
Dividends declared to preferred stockholders ($0.40 per share)	–	–	–	–	–	(4,335)	–	(4,335)
Dividends declared to common stockholders ($0.66 per share)	–	–	–	–	–	(9,388)	–	(9,388)

Balance at June 30, 2014	10,836,659	$ 170,494	14,227,243	$ 141	$ 160,431	$ 330,233	$ 55,508	$ 716,807
Balance at January 1, 2015	10,836,659	$ 170,494	14,110,859	$ 140	$ 154,965	$ 343,941	$ 64,608	$ 734,148
Net income	–	–	–	–	–	25,600	–	25,600
Other comprehensive income	–	–	–	–	–	–	(9,493)	(9,493)
Stock–based compensation	–	–	–	–	1,132	–	–	1,132
Tax benefit from exercise of stock options	–	–	–	–	342	–	–	342
Shares sold – options exercised	–	–	123,001	2	5,741	–	–	5,743
Shares issued in conversion of preferred stock to common stock	(63,947)	(1,015)	15,476	–	1,015	–	–	–
Dividends declared to preferred stockholders ($0.40 per share)	–	–	–	–	–	(4,335)	–	(4,335)
Dividends declared to common stockholders ($0.74 per share)	–	–	–	–	–	(10,534)	–	(10,534)
Balance at June 30, 2015	10,772,712	$ 169,479	14,249,336	$ 142	$ 163,195	$ 354,672	$ 55,115	$ 742,603

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

June 30, 2015

(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, 75 long-term care centers with a total of 9,423 licensed beds, 19 assisted living facilities, five independent living facilities, and 36 homecare programs. We operate specialized care units within certain of our healthcare centers such as Alzheimer's disease care units and sub-acute nursing units. 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 we lease properties to operators of skilled nursing centers. We operate in 10 states and are located primarily in the southeastern United States.

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, 2014 consolidated financial statements and notes thereto which contain accounting policies and other disclosures required by generally accepted accounting principles. Our audited December 31, 2014 consolidated financial statements are available at our web site: www.nhccare.com.

Basis of Presentation

The unaudited interim 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, 2014 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 65% 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 $25,457,000 and

$22,931,000 as of June 30, 2015 and December 31, 2014, 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 senior healthcare 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.

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.

General and Administrative Costs

With the Company being a healthcare provider, the majority of our expenses are "cost of revenue" items. Costs that could be classified as "general and administrative" by the Company would include its corporate office costs, which were $15,044,000 and $16,129,000 for the six months ended June 30, 2015 and 2014, respectively.

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 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. The accrued risk reserves include a liability for reported claims and estimates for incurred but unreported claims. Our policy is to engage an external, independent actuary to assist in estimating our exposure for claims obligations (for both asserted and unasserted claims). We reassess our accrued risk reserves on a quarterly basis.

Professional liability remains an area of particular concern to us. The long term care industry has seen an increase in personal injury/wrongful death claims based on alleged negligence by skilled nursing facilities and their employees in providing care to residents. As of June 30, 2015, we and/or our managed centers are defendants in 29 such claims inclusive of years 2005 through June 30, 2015. 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 are principally self-insured 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 Fee

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 contracts provide 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 to residents when they 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 June 30, 2015 and December 31, 2014 were $10,016,000 and $10,219,000, respectively.

Obligation to Provide Future Services

We annually estimate the present value of the cost of future services and the use of facilities to be provided to the current CCRC residents and compare that amount with the balance of non-refundable deferred revenue from entrance fees received. If the present value of the 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 June 30, 2015 and December 31, 2014, we have recorded a future service obligation in the amount of $3,927,000.

Deferred Revenue

Deferred revenue includes the deferred gain on the sale of assets to National Health Corporation ("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 February 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-02 "Amendments to the Consolidation Analysis". This update is in response to stakeholders that have expressed concerns that current generally accepted accounting principles ("GAAP") might require a reporting entity to consolidate another legal entity in situations in which the reporting entity's contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity's voting rights, or the reporting entity is not exposed to a majority of the legal entity's economic benefits or obligations. Thus, the update modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities. It eliminates the presumption that a general partner should consolidate a limited partnership, for limited partnerships and similar legal entities that qualify as voting interest entities; a limited partner with a controlling financial interest should consolidate a limited partnership. A controlling financial interest may be achieved through holding a limited partner interest that provides substantive kick-out rights. Finally, it requires consideration of the effects of fee arrangements and related parties on the primary beneficiary determination. The amendments in this update are effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. The Company is currently evaluating the impact of this guidance on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers". This update is the result of a collaborative effort by the FASB and the International Accounting Standards Board to simplify revenue recognition guidance, remove inconsistencies in the application of revenue recognition, and to improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. The FASB is amending the Accounting Standards Codification and creating a new Topic 606, "Revenue from Contracts with Customers". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For a public entity, the amendments in this update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted. The Company is currently evaluating the impact of this guidance on our consolidated financial statements and control framework.

In April 2014, the FASB issued ASU 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. The standard is effective on a prospective basis for annual periods beginning on January 1, 2015. This standard did not have a material impact on our interim condensed 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 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 June 30		Six Months Ended June 30	
(in thousands)	2015	2014	2015	2014
Management and accounting services fees	$ 3,532	$ 4,022	$ 7,036	$ 8,004
Rental income	4,776	4,749	9,578	9,517
Insurance services	1,900	1,877	3,607	3,650
Other	261	275	594	514
	$ 10,469	$ 10,923	$ 20,815	$ 21,685

Management Fees from National

We manage five skilled nursing facilities owned by National. For the three months and six months ended June 30, 2015, we recognized management fees and interest on management fees of $890,000 and $1,824,000 from these centers, respectively. For the three months and six months ended June 30, 2014, we recognized management fees and interest on management fees of $870,000 and $1,795,000, respectively, 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.

Insurance Services

For workers' compensation insurance services, the premium revenues reflected in the interim condensed consolidated statements of income for the three and six months ended June 30, 2015 were $1,203,000 and $2,213,000, respectively. For the three months and six months ended June 30, 2014, the workers' compensation premium revenues reflected in the interim condensed consolidated statements of income were $1,184,000 and $2,280,000. Associated losses and expenses are reflected in the interim condensed consolidated statements of income as "Salaries, wages and benefits."

For professional liability insurance services, the premium revenues reflected in the interim condensed consolidated statements of income for the three months and six months ended June 30, 2015 were $697,000 and $1,394,000, respectively. For the three months and six months ended June 30, 2014, the professional liability insurance premium revenues reflected in the interim condensed consolidated statements of income were $693,000 and $1,370,000. 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		Six Months Ended	
	June 30		June 30	
(in thousands)	2015	2014	2015	2014
Equity in earnings of unconsolidated investments	$ 1,268	$ 1,741	$ 2,386	$ 3,654
Dividends and other net realized gains and losses on sales of securities	1,629	1,432	3,505	2,958
Interest income	1,233	1,108	2,461	2,241
	$ 4,130	$ 4,281	$ 8,352	$ 8,853

Note 5 – Long-Term Leases

Capital Leases

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

	June 30, 2015	December 31, 2014
	(in thousands)	
Buildings and personal property	$ 39,032	$ 39,032
Accumulated amortization	(5,233)	(3,271)
	$ 33,799	$ 35,761

Operating Leases

At June 30, 2015, NHC leases from National Health Investors, Inc. ("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 $18,355,000 and $18,267,000 for the six months ended June 30, 2015 and 2014, respectively.

Minimum Lease Payments

The approximate future minimum lease payments required under all leases that have remaining non-cancelable lease terms at June 30, 2015 are as follows:

	Operating Leases	Capital Leases
	(in thousands)	
2016	$ 34,200	$ 5,200
2017	34,200	5,200
2018	34,200	5,200
2019	34,200	5,200
2020	34,200	5,200
Thereafter	228,050	19,067
Total minimum lease payments	$ 399,050	$ 45,067
Less: Amounts representing interest		(9,992)
Present value of minimum lease payments		35,075
Less: Current portion		(3,182)
Long-term capital lease obligations		$ 31,893

Note 6 – 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 June 30		Six Months Ended June 30	
	2015	2014	2015	2014
Basic:				
Weighted average common shares outstanding	13,772,873	13,868,470	13,767,248	13,855,900
Net income	$ 12,358	$ 12,511	$ 25,600	$ 25,740
Dividends to preferred stockholders	(2,167)	(2,167)	(4,335)	(4,335)
Net income available to common stockholders	$ 10,191	$ 10,344	$ 21,265	$ 21,405
Earnings per common share, basic	$ 0.74	$ 0.75	$ 1.54	$ 1.54
Diluted:				
Weighted average common shares outstanding	13,772,873	13,868,470	13,767,248	13,855,900
Dilutive effect of stock options	158,387	64,611	155,972	54,534
Dilutive effect of restricted stock	-	1,809	2,366	4,079
Dilutive effect of contingent issuable stock	450,486	347,895	410,441	312,374
Assumed average common shares outstanding	14,381,746	14,282,785	14,336,027	14,226,887
Net income available to common stockholders	$ 10,191	$ 10,344	$ 21,265	$ 21,405
Earnings per common share, diluted	$ 0.71	$ 0.72	$ 1.48	$ 1.50

In the above table, options to purchase 11,804 and 13,149 shares of our common stock have been excluded for the periods ended June 30, 2015 and 2014, respectively, due to their anti–dilutive impact. We have also excluded 2,607,427 and 2,623,007 of common shares issuable upon the conversion of preferred stock for the periods ended June 30, 2015 and 2014, respectively, due to their anti-dilutive impact.

Note 7 – 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 8 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:

	June 30, 2015		December 31, 2014	
	Amortized	Fair	Amortized	Fair
(in thousands)	Cost	Value	Cost	Value
Investments available for sale:				
Marketable equity securities	$ 30,176	$ 117,906	$ 30,176	$ 132,535
Restricted investments available for sale:				
Corporate debt securities	73,180	72,895	68,594	68,916
Commercial mortgage–backed securities	54,700	54,516	63,351	63,252
U.S. Treasury securities	21,293	21,210	14,623	14,728
State and municipal securities	16,546	16,852	11,074	11,377
	$ 195,895	$ 283,379	$ 187,818	$ 290,808

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

	June 30, 2015			December 31, 2014		
	Shares	Cost	Fair Value	Shares	Cost	Fair Value
NHI Common Stock	1,630,642	$ 24,734	$ $101,589	1,630,642	$ 24,734	$ 114,080

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

	June 30, 2015		December 31, 2014	
(in thousands)	Cost	Fair Value	Cost	Fair Value
Maturities:				
Within 1 year	$ 14,507	$ 14,551	$ 11,161	$ 11,190
1 to 5 years	77,956	78,605	83,542	84,028
6 to 10 years	70,985	70,113	58,863	58,872
Over 10 years	2,271	2,204	4,076	4,183
	$ 165,719	$ 165,473	$ 157,642	$ 158,273

Gross unrealized gains related to available for sale securities are $88,926,000 and $103,814,000 as of June 30, 2015 and December 31, 2014, respectively. Gross unrealized losses related to available for sale securities are $1,442,000 and $824,000 as of June 30, 2015 and December 31, 2014, 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. As a result, the Company recognized no other-than-temporary impairment during the six months ended June 30, 2015 or for the year ended December 31, 2014.

Proceeds from the sale of securities during the six months ended June 30, 2015 and 2014 were $28,296,000 and $27,641,000, respectively. Investment gains of $421,000 and $172,000 were realized on these sales during the six months ended June 30, 2015 and 2014, respectively.

Note 8 – 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 June 30, 2015. We did not have any transfers of assets between Level 1 and Level 2 of the fair value measurement hierarchy during the six months ended June 30, 2015.

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 June 30, 2015, 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 June 30, 2015 and December 31, 2014 for assets and liabilities measured at fair value on a recurring basis *(in thousands)*:

		Fair Value Measurements Using		
June 30, 2015	Fair Value	Quoted Prices in Active Markets For Identical Assets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

		(Level 1)		
Cash and cash equivalents	$ 71,500	$ 71,500	$ –	$ –
Restricted cash and cash equivalents	10,614	10,614	–	–
Marketable equity securities	117,906	117,906	–	–
Corporate debt securities	72,895	41,520	31,375	–
Commercial mortgage–backed securities	54,516	–	54,516	–
U.S. Treasury securities	21,210	21,210	–	–
State and municipal securities	16,852	7,838	9,014	–
Total financial assets	$ 365,493	$ 270,588	$ 94,905	$ –

		Fair Value Measurements Using		
December 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	$ 69,767	$ 69,767	$ –	$ –
Restricted cash and cash equivalents	10,651	10,651	–	–
Marketable equity securities	132,535	132,535	–	–
Corporate debt securities	68,916	39,909	29,007	–
Commercial mortgage–backed securities	63,252	–	63,252	–
U.S. Treasury securities	14,728	14,728	–	–
State and municipal securities	11,377	2,216	9,161	–
Total financial assets	$ 371,226	$ 269,806	$ 101,420	$ –

Note 9 – Long–Term Debt

Long–term debt consists of the following:

	Weighted Average	Maturities	June 30, 2015	December 31, 2014

	Interest Rate *Variable*			*(dollars in thousands)*		
Revolving Credit Facility, interest payable monthly	0.9%	2015	$	–	$	–
Unsecured term note payable to National, interest payable quarterly, principal payable at maturity	2.8%	2018		10,000		10,000
				10,000		10,000
Less current portion				–		–
			$	10,000	$	10,000

Note 10 – $75,000,000 Revolving Credit Facility

Effective October 22, 2014, 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 21, 2015.

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 11 - Stock Repurchase Program

On May 7, 2015 the Board of Directors authorized two new stock repurchase programs, one that will allow for repurchase of up to $25 million of its common stock and one that will allow for the repurchase of up to $25 million of its preferred stock. Both of the stock purchase plans expire on August 31, 2016. These stock purchase plans replace the stock purchase plan previously approved by the Board of Directors on August 5, 2014.

Under the common 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. Under the preferred stock repurchase program, the Company may repurchase its preferred 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 programs from cash on hand, available borrowings or proceeds from potential debt or other capital market sources. The stock repurchase programs may be suspended or discontinued at any time without prior notice. The Company will provide an update regarding any purchases made pursuant to the stock repurchase programs each time it reports its results of operations.

On August 11, 2014, under the previous stock purchase plan, the Company repurchased 125,000 shares of its common stock for a total cost of $6,995,000. The shares were funded from cash on hand and were cancelled and returned to the status of authorized but unissued.

Note 12 – 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. The shares granted during the six months ended June 30, 2015 consisted of 45,000 shares to the Directors of the Company. At June 30, 2015, 175,620 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. In May 2015, our stockholders voted to amend the 2010 Plan to increase the number of shares of our common stock authorized under the Plan from the original 1,200,000 shares to 2,575,000 shares. The shares granted during the six months ended June 30, 2015 consisted of 11,804 shares through the Employee Stock Purchase Plan. At June 30, 2015, 1,761,940 shares were available for future grants under the amended 2010 Plan.

Compensation expense is recognized only for the awards that ultimately vest. Stock–based compensation totaled $654,000 and $688,000 for the three months ended June 30, 2015 and 2014, respectively. Stock–based compensation totaled $1,132,000 and $1,170,000 for the six months ended June 30, 2015 and 2014, respectively. At June 30, 2015, we had $1,125,000 of unrecognized compensation cost related to unvested stock option awards. This expense will be recognized over the remaining weighted average vesting period, which is approximately 0.7 years. 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 six months ended June 30, 2015 and for the year ended December 31, 2014.

	2015	2014
Risk–free interest rate	0.70%	0.52%
Expected volatility	16.5%	17.3%
Expected life, in years	2.2 years	2.2 years
Expected dividend yield	2.73%	2.68%

The following table summarizes our outstanding stock options for the six months ended June 30, 2015 and for the year ended December 31, 2014.

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Options outstanding at January 1, 2014	1,074,552	$ 46.44	$ –
Options granted	57,716	53.10	–
Options exercised	(157,590)	45.97	–
Options cancelled	(20,000)	46.69	–
Options outstanding at December 31, 2014	954,678	46.92	–

Options granted	56,904		61.48		–
Options exercised	(123,001)		46.67		–
Options outstanding at June 30, 2015	888,581	$	47.88	$	15,202,000
Options exercisable at June 30, 2015	187,263	$	51.36	$	2,553,000

Options Outstanding June 30, 2015	Exercise Prices		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years
831,777	$44.80 - $52.93	$	46.95	1.0
56,804	$61.25 - $62.34		61.48	3.9
888,581		$	47.88	1.2

Restricted Stock

The following table summarizes our restricted stock activity for the six months ended June 30, 2015 and for the year ended December 31, 2014.

	Number of Shares		Weighted Average Grant Date Fair Value		Aggregate Intrinsic Value
Non–vested restricted shares at January 1, 2014	12,000	$	34.46	$	–
Award shares granted	–		–		–
Award shares vested	6,000		34.46		–
Non–vested restricted shares at December 31, 2014	6,000		34.46		–
Award shares granted	–		–		–
Award shares vested	6,000		34.46		–
Non–vested restricted shares at June 30, 2015	–	$	–	$	–

Note 13 – Income Taxes

The income tax provision for the three months ended June 30, 2015 is $7,478,000 (an effective income tax rate of 37.7%). The income tax provision and effective tax rate for the three months ended June 30, 2015 were unfavorably impacted by adjustments to unrecognized tax benefits of $121,000 and permanent differences including nondeductible expenses of $15,000 resulting in an increase in the provision. The income tax provision for the three months ended June 30, 2014 was $7,853,000 (an effective income tax rate of 38.6%). The income tax provision and effective tax rate for the three months ended June 30, 2014 were unfavorably impacted by adjustments to unrecognized tax benefits of $117,000 and permanent differences including nondeductible expenses of $70,000 resulting in an increase in the provision.

The income tax provision for the six months ended June 30, 2015 is $15,894,000 (an effective income tax rate of 38.3%). The income tax provision and effective tax rate for the six months ended June 30, 2015 were unfavorably impacted by adjustments to unrecognized tax benefits of $330,000 and permanent differences including nondeductible expenses of $38,000 resulting in an increase in the provision. The income tax provision for the six months ended June 30, 2014 was $16,184,000 (an effective income tax rate of 38.6%). The income tax provision and effective tax rate for the six months ended June 30, 2014 were unfavorably impacted by adjustments to unrecognized tax benefits of $306,000 and permanent differences including nondeductible expenses of $97,000 resulting in an increase in the provision.

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.

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 June 30, 2015, we had $14,600,000 of unrecognized tax benefits, composed of $9,705,000 of deferred tax assets and $4,895,000 of permanent differences. Accrued interest and penalties of $2,796,000 relate to unrecognized tax benefits at June 30, 2015. Unrecognized tax benefits of $4,895,000 net of federal benefit, at June 30, 2015, attributable to permanent differences, would favorably impact our effective tax rate if recognized. Accrued interest and penalties of $2,481,000 relate to these permanent differences at June 30, 2015. We do not expect to recognize significant increases or decreases in unrecognized tax benefits within the twelve months beginning July 1, 2015, except for the effect of decreases related to the lapse of statute of limitations estimated at $2,274,000, composed of temporary differences of $1,209,000, and permanent tax differences of $1,065,000. Interest and penalties of $623,000 relate to these temporary and permanent difference changes within 12 months beginning June 30, 2015.

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 2011 (with certain state exceptions). Currently, the 2012 U.S. federal return and one state return are under examination.

Note 14 – Contingencies and Commitments

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 $108,515,000 and $106,218,000 at June 30, 2015 and December 31, 2014, respectively. 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 consider the professional services of independent actuaries to assist us in estimating 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 June 30, 2015, we and/or our managed centers are currently defendants in 29 such claims.

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 Islands, 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, $4.0 million excess per occurrence for 2011–2013 and $9.0 million excess per occurrence for 2014-2015.

Beginning in 2008 and continuing through June 30, 2015, additional insurance is purchased through third party providers that serve to supplement the coverage provided through our wholly–owned captive insurance company.

Civil Investigative Demand

On December 19, 2013, the Company was served with a civil investigative demand ("CID") from the U.S. Department of Justice and the Office of the U.S. Attorney for the Eastern District of Tennessee ("DOJ Investigation") requesting the production of documents and interrogatory responses regarding the billing for and medical necessity of certain rehabilitative therapy services. Based upon our review, the CID appears to relate to services provided at our facilities based in Knoxville, Tennessee.

On October 7, 2014, the Company received a subpoena from the Office of Inspector General of the United Department of Health and Human Services ("OIG Subpoena") related to the current DOJ Investigation. The OIG Subpoena requests certain financial and organizational documents from the Company and certain of its subsidiaries and SNFs and medical records from certain of the Company's Tennessee-based SNFs.

The Company is cooperating fully with these requests. We are unable to evaluate the outcome of this investigation at this time. It is possible that this claim could have a material adverse effect on our consolidated financial position, results of operations and cash flows.

Caris HealthCare, L.P. Investigation

On December 9, 2014, Caris, a business that specializes in hospice care services in Company-owned health care centers and in other settings, received notice from the U.S. Attorney's Office for the Eastern District of Tennessee and the Attorney Generals' Offices for the State of Tennessee and State of Virginia that those government entities were conducting an investigation regarding patient eligibility for hospice services provided by Caris. We have a 75.1% non-controlling ownership interest in Caris.

Caris is cooperating with these government entities in connection with this investigation. We are unable to evaluate the outcome of this investigation at this time. It is possible that this claim could have a material adverse effect on our consolidated financial position, results of operations and cash flows.

There is certain additional litigation incidental to our business, none of which, in the opinion of management, 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.

South Carolina Medicaid Audits

The South Carolina Office of State Auditor (“State Auditor”) is conducting Medicaid cost report audits for eleven of the Company’s South Carolina skilled nursing facilities. The State Auditor has issued audit findings for the fiscal years ending September 30, 2013 and September 30, 2014.

The Company is cooperating fully with these audits and has filed administrative appeals with the South Carolina Department of Health and Human Services. We are unable to reasonably estimate the outcome of the appeals at this time, and accordingly have not accrued any amounts in the consolidated financial statements. It is possible these audits could have a material adverse effect on our consolidated financial position, results of operations and cash flows.

Financing Commitment

On May 7, 2015, the Board of Directors amended the line of credit agreement the Company has with National. Under the previous line of credit agreement, the maximum loan commitment was $2,000,000. Effective May 7, 2015, the maximum loan commitment has been increased to $7,000,000. The increased commitment amount will remain in effect until December 31, 2015. On January 1, 2016, the maximum loan commitment amount will revert back to $2,000,000. The final maturity of the line of credit agreement remains January 20, 2018 and the interest rate on the outstanding balance remains 85% of the prime rate, or 2.76% at June 30, 2015. As of June 30, 2015 and December 31, 2014, National had an outstanding balance on the line of credit of $3,500,000 and $0, respectively. This outstanding balance is presented in notes receivable in the interim condensed consolidated balance sheets.

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.

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, 75 long-term care centers with a total of 9,423 licensed beds, 19 assisted living facilities, five independent living facilities, and 36 homecare programs. We operate specialized care units within certain of our healthcare centers such as Alzheimer's disease care units and sub-acute nursing units. 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 we lease properties to operators of skilled nursing centers. We operate in 10 states and are located primarily in the southeastern United States.

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.

Occupancy

Occupancy, or census, in our skilled nursing facilities is a primary area of management focus. For the six months ended June 30, 2015, the total census at our owned and leased skilled nursing facilities averaged 90.1%, compared to an average of 89.0% for the same period a year ago.

The number of skilled nursing facilities in the United States has been declining for several years. Despite this decline in inventory, occupancy levels for skilled nursing facilities have also seen a steady decline during this period. We believe the steady decline of occupancy has been caused by the following factors: (1) a combination of Federal and State initiatives have led to government programs aggressively shifting more patients to home and community-based services; (2) an increased availability of continuing care retirement communities, assisted living and memory care facilities and other senior living options; and (3) a shorter average length of stay for skilled nursing patients. To monitor our census, we have developed budgets and created programs to assess facility availabilities within certain regions. We also continue to develop and enhance our relationships with the various payor sources and local referral sources in the communities in which we operate.

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 development activities.

Type of Operation	Description	Size	Location	Placed in Service
SNF/AL	Leased	120 beds / 52 units	Independence, MO	March, 2014
SNF	Leased	70 beds	Independence, MO	March, 2014
SNF/AL	Leased	130 beds / 52 units	St. Peters, MO	March, 2014
AL	Partnership	83 units	Augusta, GA	June, 2014

Psychiatric Hospital	Partnership	14 beds	Osage Beach, MO	June, 2014
SNF	New Facility	52 beds	Kingsport, TN	December,2014
SNF/AL	New Facility	92 beds/60 Units	Gallatin, TN	April, 2015
Memory Care	Partnership	60 beds	St. Peters, MO	Under construction
SNF/AL	New Facility	90 beds / 80 Units	Nashville, TN	Under construction
AL	New Facility	76 units	Bluffton, SC	Under construction
AL	New Facility	80 units	Garden City, SC	Under construction

For the projects under construction at June 30, 2015, the 60-bed memory care facility located in St. Peters, Missouri is expected to begin operations during the fourth quarter of 2015 (we have a 25% ownership interest in this partnership and a management agreement to manage the operations of the facility); the 90-bed skilled nursing facility and 80-unit assisted living facility located in Nashville, Tennessee is expected to begin operations in the second or third quarter of 2016; the 76-unit assisted living facility in Bluffton, SC is expected to begin operations in the second quarter of 2016; and the 80-unit assisted living facility in Garden City, SC is expected to begin operations in the third quarter of 2016.

During the third quarter of 2015, we anticipate beginning construction on a replacement center (SNF) that will 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 will be a partnership between NHC and Maury Regional Medical Center.

During 2015, we plan to apply for Certificates of Need for additional beds in certain of our markets. We also will 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 $108,515,000 at June 30, 2015 and are a primary area of management focus. We have set aside restricted cash and cash equivalents and marketable securities to fund 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 six month period ended June 30, 2015 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, 2014 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

In August 2014, CMS released its skilled nursing facility PPS update for the fiscal year 2015, which began October 1, 2014. The final rule provided for a 2.0% rate update, which reflected a 2.5% market basket increase less a 0.5%

multifactor productivity adjustment as required by the ACA. CMS estimated the update would increase overall payments to skilled nursing facilities in fiscal year 2015 by $750 million compared to fiscal year 2014 levels. The 2015 final rule also included wage index updates, revisions to the change of therapy (COT) other Medicare required assessment (OMRA) policy, and comments pertaining to CMS' observations on therapy utilization trends. The effect of the 2015 PPS rate update on our revenues will be dependent upon our census and the mix of our patients at the PPS payment rates.

For the first six months of 2015, our average Medicare per diem rate for skilled nursing facilities increased 0.6% compared to the same period in 2014.

On July 30, 2015, CMS released its final rule outlining the fiscal year 2016 Medicare payments for skilled nursing facilities, which begins October 1, 2015. The 2016 final rule provides for an approximate 1.2% rate update. This estimated increase consists of a 2.3% market basket increase, reduced by a 0.6% forecast error adjustment and further reduced 0.5% for a multifactor productivity adjustment required by the ACA. CMS estimates the update will increase overall payments to skilled nursing facilities in fiscal year 2016 by $430 million compared to fiscal year 2015 levels. The effect of the 2016 PPS rate update on our revenues will be dependent upon our census and the mix of our patients at the various PPS pay rates.

Medicaid – Skilled Nursing Facilities

Effective July 1, 2014 and for the fiscal year 2015, the state of Tennessee implemented individual skilled nursing facility rate changes. With new state legislation being passed for the 2015 fiscal year, there are four components that impact Tennessee Medicaid reimbursement for skilled nursing facilities: a Level I or Level II per diem, a quarterly acuity payment, a quarterly Quality Improvement in Long-Term Services and Supports ("QuILTSS") payment (which are incentives based on qualifying criteria in several categories), and an assessment fee (expense). Effective July 1, 2014, each facility will now be charged an assessment fee based on 4.5% of net patient revenues. The assessment fee is replacing the former bed tax fee. In summary and for the 2015 fiscal year, Tennessee Medicaid reimbursement changes increased income before income taxes by approximately $1,500,000 annually, or $375,000 per quarter.

Effective October 1, 2014 and for the fiscal year 2015, South Carolina implemented specific individual nursing facility rate increases. We estimate the resulting increase in revenue beginning October 1, 2014 will be approximately $1,800,000 annually, or $450,000 per quarter.

For the first six months of 2015, our average Medicaid per diem increased 1.1% compared to the same period in 2014. 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 October 30, 2014 and effective January 1, 2015, CMS released its final rule for the 2015 home health prospective payment system. The final rule reduces home health payments overall by 0.3 percent from 2014 payment levels. The payment decrease reflects the impact of the 2.1% home health payment update ($390 million increase) and the second year of the four-year phase-in of the rebasing adjustments to the national, standardized 60-day episode payment rate, the national per-visit payment rates, and the non-routine medical supplies conversion factor (2.4% or $450 million decrease). The final rule also makes adjustments to the new home health face-to-face requirements, updates the Home Health Quality Reporting Program, and discusses a potential value-based purchasing model to begin testing in 2016.

Results of Operations

Three Months Ended June 30, 2015 Compared to Three Months Ended June 30, 2014

Results for the quarter ended June 30, 2015 include a 3.9% increase in net operating revenues and a 2.6% decrease in income before income taxes compared to the same period in 2014. Excluding the operating losses from the two newly constructed skilled nursing facilities and one assisted living facility placed in service less than twelve months ago, income before income taxes for the quarter ended June 30, 2015 would have increased 6.3% compared to the same period in 2014.

The total census at owned and leased skilled nursing facilities for the quarter averaged 90.0% compared to an average of 88.7% for the same quarter a year ago.

Medicare and managed care per diem rates at our owned and leased skilled nursing facilities increased 0.9% and 1.5%, respectively, compared to the same quarter a year ago. Medicaid and private pay per diem rates at our owned and leased skilled nursing facilities increased 0.9% and 3.4%, respectively, compared to the same quarter a year ago. Overall, the composite skilled nursing per diem at our owned and leased skilled nursing facilities increased 2.9% compared to the same quarter a year ago.

Net patient revenues increased $8,801,000, or 4.3%, compared to the same quarter last year. The majority of the increase consisted of the increase in our same facility skilled nursing centers along with the three newly constructed healthcare facilities (two SNF's and one ALF) compared to the same quarter a year ago. The net patient revenues from our same facility skilled nursing centers increased $6,278,000 compared to the same quarter a year ago. The same facility revenue increase was driven by the census increase and also having a higher percentage of skilled patients (Medicare and managed care patients) compared to the same quarter a year ago. The three newly operated facilities helped increase net patient revenues $1,719,000.

Other revenues decreased $454,000, or 4.2%, compared to the same quarter last year, as further detailed in Note 3 to our interim condensed consolidated financial statements. The decrease in other revenues is primarily due to decreased accounting services fees. As of October 1, 2014, the Company no longer provides accounting and financial services to seven healthcare facilities. We expect other revenues in the consolidated statements of income to decrease by approximately $350,000 to $400,000 per quarter from the discontinuation of these services. At June 30, 2015, we provide accounting and financial services to 20 healthcare facilities.

Total costs and expenses for the second quarter of 2015 compared to the second quarter of 2014 increased $8,724,000, or 4.4%, to $209,196,000 from $200,472,000. Salaries, wages and benefits, the largest operating costs of our company, increased $6,300,000, or 5.0%, to $131,914,000 from $125,614,000. Other operating expenses increased $1,771,000, or 3.2%, to $57,467,000 for the 2015 period compared to $55,696,000 for the 2014 period. Facility rent expense increased $68,000 to $9,981,000. Depreciation and amortization increased $631,000 to $9,236,000. Interest expense decreased $46,000 to $598,000.

Salaries, wages and benefits as a percentage of net operating revenue was 58.7% compared to 58.0% for the three months ended June 30, 2015 and 2014, respectively. The increase in salaries, wages and benefits is primarily due to the increased costs for therapist services ($2,734,000) and the operations of the three newly constructed healthcare facilities ($1,345,000) compared to the quarter a year ago. We also incurred inflationary wage increases for our partners.

Other operating expenses as a percentage of net operating revenue was 25.6% compared to 25.7% for the three months ended June 30, 2015 and 2014, respectively. The increase in other operating expenses for the current quarter was due to the operations of the three newly constructed healthcare facilities compared to the quarter a year ago ($1,756,000).

Non–operating income decreased by $151,000 compared to the same period last year, as further detailed in Note 4 to our interim condensed consolidated financial statements. The decrease in non-operating income is primarily from our equity method investment in Caris, a hospice provider, which decreased $435,000 in comparison to the quarter a year ago. The Caris earnings decrease is partially offset by increased investment earnings.

The income tax provision for the three months ended June 30, 2015 is $7,478,000 (an effective income tax rate of 37.7%). The income tax provision and effective tax rate for the three months ended June 30, 2015 were unfavorably impacted by adjustments to unrecognized tax benefits of $121,000 and permanent differences including nondeductible expenses of $15,000 resulting in an increase in the provision. The income tax provision for the three months ended June 30, 2014 was $7,853,000 (an effective income tax rate of 38.6%). The income tax provision and effective tax rate for the three months ended June 30, 2014 were unfavorably impacted by adjustments to unrecognized tax benefits of $117,000 and permanent differences including nondeductible expenses of $70,000 resulting in an increase in the provision.

Six Months Ended June 30, 2015 Compared to Six Months Ended June 30, 2014

Results for the six month period ended June 30, 2015 include a 4.7% increase in net operating revenues and a 1.0% decrease in income before income taxes compared to the same period in 2014. Excluding the operating losses from the five newly constructed or leased skilled nursing facilities and three assisted living facilities placed in service less than twelve months ago, income before income taxes for the six months ended June 30, 2015 would have increased 7.2% compared to the same period in 2014.

The total census at owned and leased skilled nursing facilities for the six months averaged 90.1% compared to an average of 89.0% for the same period a year ago.

Medicare and managed care per diem rates at our owned and leased skilled nursing facilities increased 0.6% and 0.4%, respectively, compared to the six months a year ago. Medicaid and private pay per diem rates at our owned and leased skilled nursing facilities increased 1.1% and 2.8%, respectively, compared to the period a year ago. Overall, the composite skilled nursing per diem at our owned and leased skilled nursing facilities increased 2.7% compared to the six months a year ago.

Net patient revenues increased $21,093,000, or 5.2%, compared to the same period last year. The majority of the increase consisted of the increase in our same facility skilled nursing centers along with the eight newly constructed or leased healthcare facilities (five SNF's and three ALF's) compared to the same six month period a year ago. The net patient revenues from our same facility skilled nursing centers increased $10,962,000 compared to the six month period a year ago. The same facility revenue increase was driven by the census increase and also having a higher percentage of skilled patients (Medicare and managed care patients) compared to the six month period a year ago.

The eight newly operated facilities helped increase net patient revenues $8,358,000.

Other revenues decreased $870,000, or 4.0%, compared to the same period last year, as further detailed in Note 3 to our interim condensed consolidated financial statements. The decrease in other revenues is primarily due to decreased accounting services fees. As of October 1, 2014, the Company no longer provides accounting and financial services to seven healthcare facilities. We expect other revenues in the consolidated statements of income to decrease by approximately $350,000 to $400,000 per quarter from the discontinuation of these services. At June 30, 2015, we provide accounting and financial services to 20 healthcare facilities.

Total costs and expenses for the 2015 six months compared to the same period in 2014 increased $20,152,000, or 5.1%, to $414,167,000 from $394,015,000. Salaries, wages and benefits, the largest operating costs of our company, increased $12,291,000, or 5.0%, to $257,630,000 from $245,339,000. Other operating expenses increased $5,776,000, or 5.2%, to $117,214,000 for the 2015 period compared to $111,438,000 for the 2014 period. Facility rent expense increased $167,000 to $19,966,000. Depreciation and amortization increased $1,664,000 to $18,169,000. Interest expense increased $254,000 to $1,188,000.

Salaries, wages and benefits as a percentage of net operating revenue was 57.6% compared to 57.4% for the six months ended June 30, 2015 and 2014, respectively. The increase in salaries, wages and benefits is primarily due to the increased costs for therapist services ($5,347,000) and the new operations of the eight healthcare facilities ($5,083,000) compared to the same six month period a year ago. We also incurred inflationary wage increases for our partners.

Other operating expenses as a percentage of net operating revenue was 26.2% compared to 26.1% for the six months ended June 30, 2015 and 2014, respectively. The increase in other operating expenses for the current period was due to the new operations of the eight healthcare facilities compared to the same period a year ago ($5,137,000).

The increase in depreciation expense is due to the new healthcare facilities and the increase in interest expense is due to the capital leases recorded for the three Missouri healthcare facilities we began operating on March 1, 2014.

Non–operating income decreased by $501,000 compared to the same six month period last year, as further detailed in Note 4 to our interim condensed consolidated financial statements. The decrease in non-operating income is primarily from our equity method investment in Caris, a hospice provider, which decreased $1,056,000 in comparison to the same period a year ago. The Caris earnings decrease is partially offset by increased investment earnings.

The income tax provision for the six months ended June 30, 2015 is $15,894,000 (an effective income tax rate of 38.3%). The income tax provision and effective tax rate for the six months ended June 30, 2015 were unfavorably impacted by adjustments to unrecognized tax benefits of $330,000 and permanent differences including nondeductible expenses of $38,000 resulting in an increase in the provision. The income tax provision for the six months ended June 30, 2014 was $16,184,000 (an effective income tax rate of 38.6%). The income tax provision and effective tax rate for the six months ended June 30, 2014 were unfavorably impacted by adjustments to unrecognized tax benefits of $306,000 and permanent differences including nondeductible expenses of $97,000 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 and accounting services, and rental income. 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)*:

	Six Months Ended June 30		Six Month Change	
	2015	2014	$	%
Cash and cash equivalents at beginning of period	$ 69,767	$ 81,705	$ (11,938)	(14.6)%
Cash provided by operating activities	40,176	26,995	13,181	48.8%
Cash used in investing activities	(29,296)	(25,041)	(4,255)	(17.0)%
Cash used in financing activities	(9,147)	(7,901)	(1,246)	(15.8)%
Cash and cash equivalents at end of period	$ 71,500	$ 75,758	$ (4,258)	(5.6)%

Operating Activities

Net cash provided by operating activities for the six months ended June 30, 2015 was $40,176,000, as compared to $26,995,000 in the same period last year. Cash provided by operating activities consisted of net income of $25,600,000, adjustments for non–cash items of $18,195,000, and cash distributions in excess of earnings from equity method investments of $2,363,000. There was cash used for working capital in the amount of $5,561,000 and also gains on the sale of restricted marketable securities ($421,000) that offset against the positive operating cash flow items stated above.

Cash used for working capital primarily consisted of a decrease in accrued payroll and an increase in restricted cash and cash equivalents. The majority of the decrease in accrued payroll is due to the timing and payments of incentive compensation related to the 2014 year. The increase in restricted cash and cash equivalents is due to NHC healthcare entities paying insurance premiums to our wholly-owned insurance companies, which restrict the cash payment.

Investing Activities

Cash used in investing activities totaled $29,296,000 and $25,041,000 for the six months ended June 30, 2015 and 2014, respectively. Cash used for property and equipment additions was $23,046,000 for the six months ended June 30, 2015 and $22,963,000 in the comparable period in 2014. The Company made investments in unconsolidated partnerships in the amount of $323,000 and $1,312,000 for the six months ended June 30, 2015 and 2014, respectively. The Company made investments in notes receivable of $4,237,000 and $767,000 for the six months ended June 30, 2015 and 2014, respectively. The largest notes receivable investment for the 2015 six month period was a $3,500,000 advance to National. Purchases and sales of restricted marketable securities (including the use of restricted cash and cash equivalents) resulted in a net use of cash of $1,918,000 for the 2015 period compared to $2,168,000 for the 2014 period.

In 2015, construction costs included in additions to property and equipment include $4,026,000 for the final construction and furnishings of the 92-bed skilled nursing facility and 60-unit assisted living facility in Gallatin, Tennessee, $8,667,000 for continued construction on the 90-bed skilled nursing facility and 80-unit assisted living facility located in Nashville, Tennessee, and $1,023,000 for the acquisition of land in Hermitage, Tennessee.

Financing Activities

Net cash used in financing activities totaled $9,147,000 and $7,901,000 for the six months ended June 30, 2015 and 2014, respectively. Cash used for dividend payments to common and preferred stockholders totaled $14,002,000 in the current year period compared to $13,413,000 for the same period a year ago. In the current period, $5,743,000 was provided by the issuance of common stock compared to $6,752,000 in the prior year period.

Table of Contractual Obligations

Our contractual obligations as of June 30, 2015 are as follows *(in thousands)*:

	Total	1 year	2–3 Years	4–5 Years	After 5 Years
Long–term debt – principal	$ 10,000	$ –	$ 10,000	$ –	$ –
Long–term debt – interest	690	276	414	–	–
Operating leases	399,050	34,200	68,400	68,400	228,050
Construction obligations	23,114	23,114	–	–	–
Capital lease obligations	45,067	5,200	10,400	10,400	19,067
Total contractual cash obligations	$ 477,921	$ 62,790	$ 89,214	$ 78,800	$ 247,117

Other noncurrent liabilities for uncertain tax positions of $4,895,000, attributable to permanent differences, at June 30, 2015 have 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 13 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 $71,500,000 at June 30, 2015, marketable securities of $117,906,000 at June 30, 2015, 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 21, 2015. We currently anticipate renewing the credit agreement. We entered into this credit agreement originally on October 30, 2007, and have renewed the loan seven 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 ("CID") from the U.S. Department of Justice and the Office of the U.S. Attorney for the Eastern District of Tennessee ("DOJ Investigation") requesting the production of documents and interrogatory responses regarding the billing for and medical necessity of certain rehabilitative therapy services. Based upon our review, the CID appears to relate to services provided at our facilities based in Knoxville, Tennessee.

On October 7, 2014, the Company received a subpoena from the Office of Inspector General of the United Department of Health and Human Services ("OIG Subpoena") related to the current DOJ Investigation. The OIG Subpoena requests certain financial and organizational documents from the Company and certain of its subsidiaries and SNFs and medical records from certain of the Company's Tennessee-based SNFs.

The Company is cooperating fully with these requests. We are unable to evaluate the outcome of this investigation at this time. It is possible that this claim could have a material adverse effect on our consolidated financial position, results of operations and cash flows.

Caris HealthCare, L.P. Investigation

On December 9, 2014, Caris Healthcare, L.P. ("Caris"), a business that specializes in hospice care services in Company-owned health care centers and in other settings in Missouri, Tennessee, South Carolina and Virginia, received notice from the U.S. Attorney's Office for the Eastern District of Tennessee and the Attorney Generals' Offices for the State of Tennessee and State of Virginia that those government entities were conducting an investigation regarding patient eligibility for hospice services provided by Caris. We have a 75.1% non-controlling ownership interest in Caris.

Caris is cooperating with these government entities in connection with this investigation. We are unable to evaluate the outcome of this investigation at this time. It is possible that this claim could have a material adverse effect on our consolidated financial position, results of operations and cash flows.

There is certain additional litigation incidental to our business, none of which, in the opinion of management, 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.

South Carolina Medicaid Audits

The South Carolina Office of State Auditor ("State Auditor") is conducting Medicaid cost report audits for eleven of the Company's South Carolina skilled nursing facilities. The State Auditor has issued audit findings for the fiscal years ending September 30, 2013 and September 30, 2014.

The Company is cooperating fully with these audits and has filed administrative appeals with the South Carolina Department of Health and Human Services. We are unable to reasonably estimate the outcome of the appeals at this time, and accordingly have not accrued any amounts in the consolidated financial statements. It is possible these audits could have a material adverse effect on our consolidated financial position, results of operations and cash flows.

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 expressions are forward–looking stateme

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;

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

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the ability to refinance existing debt on favorable terms;

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the competitive environment in which we operate;

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the ability to maintain and increase census levels; and

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demographic changes.

See the notes to the quarterly financial statements, and “Item 1. Business” in our 2014 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 June 30, 2015, we have available for sale debt securities in the amount of $165,473,000. 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 June 30, 2015, 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 $8.6 million of our notes receivable bear interest at variable rates (generally at the prime rate plus 2%). Because the interest rates of these instruments are variable, a hypothetical 1% change in interest rates would result in a related increase or decrease in interest income of approximately $86,000.

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 June 30, 2015, the fair value of our equity marketable securities is approximately $117,906,000. Of the $117.9 million equity securities portfolio, our investment in National Health Investors, Inc. ("NHI") comprises approximately $101.6 million, or 86%, 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 $11.8 million. At June 30, 2015, our equity securities had unrealized gains of $87.7 million. Of the $87.7 million of unrealized gains, $76.8 million is related to our investment in NHI.

Item 4. Controls and Procedures.

As of June 30, 2015, 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 June 30, 2015. There have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2015 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 14 of this Form 10–Q.

Item 1A. Risk Factors.

During the six months ended June 30, 2015, 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, 2014.

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
2.1	Agreement and plan of Merger, dated December 20, 2006, by and among Davis Acquisition Sub LLC, NHC/OP, L.P., NHC and NHR	Incorporated by reference to Exhibit 2.1 to the current report on Form 8-K, filed with the SEC on December 20, 2006
2.2	Amendment and Waiver No. 1 to Agreement and Plan of Merger, dated April 6, 2007 by and among Davis Acquisition Sub LLC, NHC/OP, L.P., NHC and NHR	Incorporated by reference to Exhibit 10.1 to the current report on Form 8-K filed on April 11, 2007
2.3	Amendment No. 2 to Agreement and Plan of Merger, dated August 3,2007, by and among Davis Acquisition Sub LLC, NHC/OP, L.P., NHC and NHR	Incorporated by reference to Exhibit 2.1 to the current report on Form 8-K filed on August 6, 2007
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	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	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
10.1	Seventh Amendment to Credit Agreement, dated October 22, 2014, between National HealthCare Corporation and Bank of America, N.C.	Incorporated by reference to exhibit 10.1 to our current report on Form 8-K filed October 23, 2014
31.1		Filed Herewith

	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	
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: August 6, 2015

/s/ Robert G. Adams
Robert G. Adams
Chief Executive Officer

Date: August 6, 2015

/s/ Donald K. Daniel
Donald K. Daniel
Senior Vice President and Controller
(Principal Accounting Officer)