

NATIONAL HEALTHCARE CORP  
Form 10-K/A  
August 23, 2013

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 10-K/A**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2012**

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 No. 001-13489**

(Exact name of registrant as specified in its Corporate Charter)

**Delaware**  
(State of Incorporation)

**52-2057472**  
(I.R.S. Employer I.D. No.)

**100 Vine Street**  
**Murfreesboro, Tennessee 37130**  
(Address of principal executive offices)  
Telephone Number: **615-890-2020**

Securities registered pursuant to Section 12(b) of the Act.

Title of Each Class	Name of Each Exchange on which Registered
<b>Shares of Common Stock</b>	<b>NYSE MKT</b>
<b>Shares of Preferred Cumulative Convertible Stock</b>	<b>NYSE MKT</b>

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Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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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  No

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

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Act). Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

The aggregate market value of Common Stock held by non-affiliates on June 30, 2012 (based on the closing price of such shares on the NYSE MKT) was approximately \$308 million. For purposes of the foregoing calculation only, all directors, named executive officers and persons known to the Registrant to be holders of 5% or more of the Registrant's Common Stock have been deemed affiliates of the Registrant.

The number of shares of Common Stock outstanding as of February 12, 2013 was 14,158,127.

**Documents Incorporated by Reference**

The following documents are incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 of this Form 10-K:  
The Registrant's definitive proxy statement for its 2013 shareholder's meeting.

**EXPLANATORY NOTE**

The Company is filing this Amendment No. 1 to its Annual Report on Form 10-K for the year ended December 31, 2012 which was originally filed with the Securities and Exchange Commission on February 15, 2013, for the sole purpose of properly dating the auditor's reports in accordance with Rule 2-02(a)(1) of Regulation S-X.

No other changes have been made to the previously filed Form 10-K. This Amendment does not reflect events that have occurred after the February 15, 2013 filing date of the previously filed Form 10-K, or modify or update the disclosures presented therein, except to reflect the amendment described above.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

National HealthCare Corporation

We have audited the accompanying consolidated balance sheets of National HealthCare Corporation as of December 31, 2012 and 2011 and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of National HealthCare Corporation at December 31, 2012 and 2011 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), National HealthCare Corporation's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 15, 2013, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Nashville, Tennessee

February 15, 2013

**NATIONAL HEALTHCARE CORPORATION****Consolidated Statements of Income***(in thousands, except share and per share amounts)*

	Year Ended December 31,		
	2012	2011	2010
<b>Revenues:</b>			
Net patient revenues	\$ 705,386	\$ 715,489	\$ 663,629
Other revenues	55,876	58,048	57,024
Net operating revenues	761,262	773,537	720,653
<b>Costs and Expenses:</b>			
Salaries, wages and benefits	426,934	428,672	400,270
Other operating	198,691	198,439	197,016
Rent	39,355	39,736	38,086
Depreciation and amortization	29,792	28,901	27,141
Interest	455	443	513
Total costs and expenses	695,227	696,191	663,026
Income Before Non-Operating Income	66,035	77,346	57,627
Non-Operating Income	25,245	20,533	23,340
Income Before Income Taxes	91,280	97,879	80,967
Income Tax Provision	(33,323)	(33,807)	(28,272)
Net Income	57,957	64,072	52,695
Dividends to Preferred Stockholders	(8,671)	(8,671)	(8,673)
Net Income Available to Common Stockholders	\$ 49,286	\$ 55,401	\$ 44,022
<b>Earnings Per Common Share:</b>			
Basic	\$ 3.56	\$ 4.02	\$ 3.22
Diluted	\$ 3.49	\$ 3.90	\$ 3.22
<b>Weighted Average Common Shares Outstanding:</b>			
Basic	13,852,709	13,774,628	13,671,053
Diluted	16,598,816	16,414,023	13,676,476

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

**NATIONAL HEALTHCARE CORPORATION****Consolidated Statements of Comprehensive Income***(in thousands)*

	Year Ended December 31,		
	2012	2011	2010
Net Income	\$ 57,957	\$ 64,072	\$ 52,695
Other Comprehensive Income:			
Unrealized gains on investments in marketable securities	23,099	598	15,016
Income tax expense related to items of other comprehensive income	(8,993)	(183)	(5,809)
Other comprehensive income, net of tax	14,106	415	9,207
Comprehensive Income	\$ 72,063	\$ 64,487	\$ 61,902



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

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

	December 31,	
	2012	2011
Assets		
Current Assets:		
Cash and cash equivalents	\$ 66,701	\$ 61,008
Restricted cash and cash equivalents	11,563	50,587
Marketable securities	107,250	85,051
Restricted marketable securities	135,207	83,625
Accounts receivable, less allowance for doubtful accounts of \$3,166 and \$3,713, respectively	74,693	71,696
Inventories	6,660	7,419
Prepaid expenses and other assets	1,132	1,082
Notes receivable	5,840	1,260
Federal income tax receivable	5,933	6,470
Total current assets	414,979	368,198
Property and Equipment:		
Property and equipment, at cost	675,455	659,523
Accumulated depreciation and amortization	(254,548)	(229,872)
Net property and equipment	420,907	429,651
Other Assets:		
Deposits	143	397
Goodwill	17,600	20,320
Notes receivable	15,949	21,189
Deferred income taxes	10,564	10,167
Investments in limited liability companies	40,039	20,502
Total other assets	84,295	72,575
Total assets	\$ 920,181	\$ 870,424

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



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

	December 31,	
	2012	2011
Liabilities and Stockholders' Equity		
Current Liabilities:		
Trade accounts payable	\$ 10,555	\$ 9,834
Accrued payroll	37,243	54,063
Amounts due to third party payors	17,001	16,807
Accrued risk reserves	110,331	98,732
Deferred income taxes	24,474	14,526
Other current liabilities	20,411	20,335
Dividends payable	6,480	6,362
Total current liabilities	226,495	220,659
Long-Term Debt	10,000	10,000
Other Noncurrent Liabilities	13,890	16,244
Deferred Revenue	10,124	11,785
Stockholders' Equity:		
Series A Convertible Preferred Stock; \$.01 par value; 25,000,000 shares authorized; 10,838,412 and 10,838,490 shares, respectively, issued and outstanding; stated at liquidation value of \$15.75 per share	170,514	170,515
Common stock, \$.01 par value; 30,000,000 shares authorized; 14,158,127 and 13,862,738 shares, respectively, issued and outstanding	141	138
Capital in excess of par value	154,692	139,183
Retained earnings	283,517	265,198
Accumulated other comprehensive income	50,808	36,702
Total stockholders' equity	659,672	611,736
Total liabilities and stockholders' equity	\$ 920,181	\$ 870,424

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

## NATIONAL HEALTHCARE CORPORATION

## Consolidated Statements of Cash Flows

*(in thousands)*

	Year Ended December 31,		
	2012	2011	2010
<b>Cash Flows From Operating Activities:</b>			
Net income	\$ 57,957	\$ 64,072	\$ 52,695
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	29,792	28,901	27,141
Provision for doubtful accounts receivable	2,455	2,430	2,256
Equity in earnings of unconsolidated investments	(13,616)	(9,674)	(8,993)
Distributions from unconsolidated investments	6,317	10,828	6,462
Recovery of assets in acquisition of healthcare centers	—	—	(3,563)
Gains on sale of marketable securities	(1,640)	(754)	(891)
Deferred income taxes	558	1,990	3,505
Stock-based compensation	2,366	2,751	321
Changes in operating assets and liabilities, net of the effect of acquisitions:			
Restricted cash and cash equivalents	(7,636)	(7,830)	(2,509)
Accounts receivable	(7,263)	5,032	(15,817)
Income tax receivable	537	(3,779)	3,470
Inventories	759	434	(372)
Prepaid expenses and other assets	(77)	169	(166)
Trade accounts payable	831	(1,113)	(352)
Accrued payroll	(16,418)	2,008	5,205
Amounts due to third party payors	481	(860)	(891)
Other current liabilities and accrued risk reserves	11,675	(9,129)	(103)
Other noncurrent liabilities	(2,354)	(2,617)	(3,772)
Deferred revenue	(31)	(35)	(265)
Net cash provided by operating activities	64,693	82,824	63,361
<b>Cash Flows From Investing Activities:</b>			
Additions to and acquisitions of property and equipment	(22,003)	(23,372)	(32,293)
Acquisition of non-controlling interest in hospice business	(7,500)	(7,500)	—
Acquisition of homecare business	—	—	(14,342)
Collections of notes receivable, net	660	1,222	1,300
Decrease in restricted cash and cash equivalents	46,660	9,235	47,451
Purchases of marketable securities	(111,691)	(57,597)	(93,305)
Sale of marketable securities	62,649	46,266	43,849
Cash acquired in acquisition of facilities	—	—	989
	(31,225)	(31,746)	(46,351)

	Net cash used in investing activities		
<b>Cash Flows From Financing Activities:</b>			
Tax (expense) benefit from stock-based compensation	(267)	(52)	154
Dividends paid to preferred stockholders	(8,671)	(8,671)	(8,673)
Dividends paid to common stockholders	(30,849)	(15,952)	(14,780)
Issuance of common shares	13,412	8,392	2,655
Repurchase of common shares	-	-	(5,944)
Entrance fee refunds	(1,630)	(2,170)	(957)
(Increase) decrease in deposits	230	(95)	21
Other	-	-	(30)
	Net cash used in financing activities	(27,775)	(18,548)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	5,693	32,530	(10,544)
<b>Cash and Cash Equivalents, Beginning of Period</b>	61,008	28,478	39,022
<b>Cash and Cash Equivalents, End of Period</b>	\$ 66,701	\$ 61,008	\$ 28,478

## NATIONAL HEALTHCARE CORPORATION

## Consolidated Statements of Cash Flows

*(continued)*

<i>(in thousands)</i>	Year Ended December 31,		
	2012	2011	2010
<b>Supplemental Information:</b>			
Cash payments for interest	\$ 383	\$ 501	\$ 658
Cash payments for income taxes	34,142	40,798	22,969
Non-cash activities include:			
Effective January 1, 2012, NHC assigned the assets and liabilities of eight Solaris Hospice programs to Caris in exchange for an additional limited partnership interest.			
Current assets assigned	1,862	—	—
Property and equipment assigned	303	—	—
Current liabilities assigned	(799)	—	—
Goodwill	2,945	—	—
Investment in limited liability company	(4,311)	—	—
Effective December 1, 2010, NHC acquired the assets and assumed certain liabilities of two 120-bed long-term health care centers. The consideration given was first mortgage bonds owned by NHC.			
Real and personal property	—	—	(4,873)
Current assets acquired	—	—	(1,958)
Current liabilities acquired	—	—	1,623
First mortgage revenue bonds	—	—	1,645
Gain on recovery of assets	—	—	3,563



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

**NATIONAL HEALTHCARE CORPORATION****Consolidated Statements of Stockholders' Equity***(in thousands, except for share and per share amounts)*

	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, 2010	10,841,062	\$ 170,555	13,717,701	\$ 137	\$ 130,867	\$ 197,140	\$ 27,080	\$ 525,779
Net income	—	—	—	—	—	52,695	—	52,695
Other comprehensive income	—	—	—	—	—	—	9,207	9,207
Stock-based compensation	—	—	—	—	321	—	—	321
Tax benefit from exercise of stock options	—	—	—	—	154	—	—	154
Shares sold - options exercised	—	—	102,349	1	2,654	—	—	2,655
Shares repurchased	—	—	(182,900)	(2)	(5,942)	—	—	(5,944)
Shares issued in conversion of preferred stock to common stock	(454)	(7)	108	—	7	—	—	—
Dividends declared to preferred stockholders (\$0.80 per share)	—	—	—	—	—	(8,673)	—	(8,673)
Dividends declared to common stockholders (\$1.10 per share)	—	—	—	—	—	(15,048)	—	(15,048)
Balance at December 31, 2010	10,840,608	\$ 170,548	13,637,258	\$ 136	\$ 128,061	\$ 226,114	\$ 36,287	\$ 561,146
Net income	—	—	—	—	—	64,072	—	64,072

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Other comprehensive income	-	-	-	-	-	-	415	415
Stock-based compensation	-	-	-	-	2,751	-	-	2,751
Tax expense from exercise of stock options	-	-	-	-	(52)	-	-	(52)
Shares sold - options exercised	-	-	224,969	2	8,390	-	-	8,392
Shares issued in conversion of preferred stock to common stock	(2,118)	(33)	511	-	33	-	-	-
Dividends declared to preferred stockholders (\$0.80 per share)	-	-	-	-	-	(8,671)	-	(8,671)
Dividends declared to common stockholders (\$1.18 per share)	-	-	-	-	-	(16,317)	-	(16,317)
Balance at December 31, 2011	10,838,490	\$ 170,515	13,862,738	\$ 138	\$ 139,183	\$ 265,198	\$ 36,702	\$ 611,736
Net income	-	-	-	-	-	57,957	-	57,957
Other comprehensive income	-	-	-	-	-	-	14,106	14,106
Stock-based compensation	-	-	-	-	2,366	-	-	2,366
Tax expense from exercise of stock options	-	-	-	-	(267)	-	-	(267)
Shares sold - options exercised	-	-	295,371	3	13,409	-	-	13,412
Shares issued in conversion of preferred stock to common stock	(78)	(1)	18	-	1	-	-	-
Dividends declared to preferred stockholders (\$0.80 per share)	-	-	-	-	-	(8,671)	-	(8,671)
Dividends declared to common stockholders	-	-	-	-	-	(30,967)	-	(30,967)

(\$2.20 per share)

Balance at December 31, 2012	10,838,412	\$ 170,514	14,158,127	\$ 141	\$ 154,692	\$ 283,517	50,808	\$ 659,672
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*The accompanying notes to consolidated financial statements are an integral part of these consolidated statements.*

## Notes to Consolidated Financial Statements

### Note 1 - Summary of Significant Accounting Policies

#### *Nature of Operations*

National HealthCare Corporation ("NHC" or "the Company") operates, manages or provides services to long-term health care centers and associated assisted living centers, retirement centers and home health care programs located in 11 Southeastern, Northeastern and Midwestern states in the United States. The most significant part of our business relates to skilled and intermediate nursing care in which setting we provide assisted living and retirement services, rehabilitative therapy services, and home health care. We also have a non-controlling ownership interest in a hospice care business that services NHC owned health care centers and others. The long-term health care environment has continually undergone changes with regard to Federal and state reimbursement programs and other payor sources, compliance regulations, competition among other health care providers and patient care litigation issues. We continually monitor these industry developments as well as other factors that affect our business.

#### *Principles of Consolidation and Basis of Presentation*

The consolidated financial statements which are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") include our wholly owned and controlled subsidiaries and affiliates. Variable interest entities ("VIEs") in which we have an interest have been consolidated when we have been identified as the primary beneficiary. Investments in ventures in which we have the ability to exercise significant influence but do not have control over are accounted for using the equity method. Equity method investments are initially recorded at cost and subsequently are adjusted for our share of the venture's earnings or losses and cash distributions. Our most significant equity method investment is a 75.1% non-controlling ownership interest in Caris Healthcare, LP ("Caris"), a business that specializes in hospice care services. Investments in entities in which we lack the ability to exercise significant influence are included in the consolidated financial statements at cost unless there has been a decline in the market value of our investment that is deemed to be other than temporary. All material intercompany transactions and balances have been eliminated in consolidation.

#### *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management 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.

*Net Patient Revenues and Accounts Receivable*

Revenues are derived from services rendered to patients for long-term care, including skilled and intermediate nursing, rehabilitation therapy, hospice, assisted living and retirement and home health care services.

Revenues are recorded when services are provided based on established rates adjusted to amounts expected to be received under governmental programs and other third-party contractual arrangements based on contractual terms. These revenues and receivables are stated at amounts estimated by management to be at their net realizable value.

For private pay patients in skilled nursing or assisted living and retirement facilities, we bill in advance for the following month, with the remittance being due on receipt of the statement and generally by the 10th day of the

month the services are performed. A portion of the episodic Medicare payments for home health services are also received in advance of the services being rendered. All advance billings are initially deferred and then are recognized as revenue when the services are performed.

We receive payments from the Medicare program under a prospective payment system ("PPS"). For skilled nursing services, Medicare pays a fixed fee per Medicare patient per day, based on the acuity level of the patient, to cover all post-hospital extended care routine service costs, ancillary costs and capital related costs.

Medicaid program payments for long-term care services are generally based on fixed per diem rates subject to program cost ceilings.

For homecare services, Medicare pays based on the acuity level of the patient and based on episodes of care. An episode of care is defined as a length of care up to 60 days with multiple continuous episodes allowed. The services covered by the episode payment include all disciplines of care, in addition to medical supplies, within the scope of the home health benefit. We are allowed to make a request for anticipated payment at the start of care equal to 60% of the expected payment for the initial episode. The remaining balance due is paid following the submission of the final claim at the end of the episode. Revenues are recognized when services are provided based on the number of days of service rendered in the episode. Deferred revenue is recorded for payments received for which the related services have not yet been provided.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Noncompliance with such laws and regulations can be subject to regulatory actions including fines, penalties, and exclusion from the Medicare and Medicaid programs. We believe that we are in material compliance with all applicable laws and regulations.

Medicare program revenues, as well as certain Medicaid program revenues, are subject to audit and retroactive adjustment by government representatives. The Medicare PPS methodology requires that patients be assigned to Resource Utilization Groups ("RUGs") based on the acuity level of the patient to determine the amount paid to us for patient services. The assignment of patients to the various RUG categories is subject to post-payment review by Medicare intermediaries or their agents. In our opinion, adequate provision has been made for any adjustments that may result from these reviews. Retroactive adjustments are estimated in the recording of revenues in the period the related services are rendered. 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 believe currently that any differences between the net revenues recorded and final determination will not materially affect the consolidated financial statements. We have made provisions of approximately \$17,001,000 as of December 31, 2012 for various Medicare and Medicaid current and prior year cost reports and claims reviews.

Approximately 67% of our net patient revenues are derived from participation in Medicare and Medicaid programs and other government programs.

*Other Revenues*

As discussed in Note 4 other revenues include revenues from the provision of insurance, management and accounting services to other long-term care providers, and rental income. Our insurance revenues consist of premiums that are generally paid in advance and then amortized into income as earned over the related policy period. We charge for management services based on a percentage of net revenues. We charge for accounting services based on a monthly fee or a fixed fee per bed of the long-term care center under contract. We generally record other revenues on the accrual basis based on the terms of our contractual arrangements. However, with respect to management and accounting services revenue from certain long-term care providers, including but not limited to National Health Corporation ("National") as discussed in Note 4, where collection is not reasonably assured based on insufficient historical collections and the lack of expected future collections, our policy is to



recognize income only in the period in which collection is assured and the amounts at question are believed by management to be fixed and determined.

Certain management contracts, including, but not limited to contracts with National, subordinate the payment of management fees earned under those contracts to other expenditures of the long-term care center and to the availability of cash provided by the facility's operations. Revenues from management services provided to the facilities that generate insufficient cash flow to pay the management fee, as prioritized under the contractual arrangement, are not recognized until such time as the amount of revenue earned is fixed or determinable and collectability is reasonably assured. This recognition policy could cause our reported revenues and net income from management services to vary significantly from period to period.

We recognize rental income based on the terms of our operating leases. Under certain of our leases, we receive contingent rent, which is based on the increase in revenues of a lessee over a base year. We recognize contingent rent annually or monthly, as applicable, when, based on the actual revenue of the lessee, receipt of such income is assured. We identify leased real estate properties as nonperforming if a required payment is not received within 30 days of the date it is due. Our policy related to rental income on non-performing leased real estate properties is to recognize rental income in the period when the income is received.

#### *Non-Operating Income*

As discussed in Note 5, non-operating income includes equity in earnings of unconsolidated investments, dividends and realized gains on securities, interest income, and other miscellaneous non-operating income.

#### *Provision for Doubtful Accounts*

We evaluate the collectability of our accounts receivable based on factors such as payor type, historical collection trends and aging categories. We review these factors and determine an estimated provision for doubtful accounts. Historically, bad debts have resulted primarily from uncollectible private balances or from uncollectible coinsurance and deductibles. Receivables that are deemed to be uncollectible are written off against the allowance. The allowance for doubtful accounts balance is assessed on a quarterly basis, with changes in estimated losses being recorded in the consolidated statements of income in the period first identified.

The Company includes provisions for doubtful accounts in operating expenses in its consolidated statements of income. The provisions for doubtful accounts were \$2,455,000, \$2,430,000, and \$2,256,000 for 2012, 2011 and 2010, 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.

Expenditures for repairs and maintenance are charged against income as incurred. Betterments, which significantly extend the useful life, are capitalized. We remove the costs and related allowances for accumulated depreciation or amortization from the accounts for properties sold or retired, and any resulting gains or losses are included in income.

In accordance with Accounting Standards Codification ("ASC") Topic 360, *Property, Plant, and Equipment*, we evaluate the recoverability of the carrying values of our properties on a property by property basis. We review our properties for recoverability when events or circumstances, including significant physical changes in the property, significant adverse changes in general economic conditions, and significant deteriorations of the

underlying cash flows of the property, indicate that the carrying amount of the property may not be recoverable. The need to recognize an impairment is based on estimated future undiscounted cash flows from a property over the remaining useful life compared to the carrying value of that property. If recognition of an impairment is necessary, it is measured as the amount by which the carrying amount of the property exceeds the estimated fair value of the property.

#### *Mortgage and Other Notes Receivable*

In accordance with ASC Topic 310, *Receivables*, NHC evaluates the carrying values of its mortgage and other notes receivable on an instrument by instrument basis. On a quarterly basis, NHC reviews its notes receivable for recoverability when events or circumstances, including the non-receipt of contractual principal and interest payments, significant deteriorations of the financial condition of the borrower and significant adverse changes in general economic conditions, indicate that the carrying amount of the note receivable may not be recoverable. If necessary, an impairment is measured as the amount by which the carrying amount exceeds the discounted cash flows expected to be received under the note receivable or, if foreclosure is probable, the fair value of the collateral securing the note receivable.

#### *Investments in Marketable Securities and Restricted Marketable Securities*

Our investments in marketable securities and restricted marketable securities include available for sale securities, which are recorded at fair value. Unrealized gains and losses on available for sale securities that are deemed temporary are recorded as a separate component of stockholders' equity. If any adjustment to fair value reflects a significant decline in the value of the security, we consider all available evidence to evaluate the extent to which the decline is "other than temporary". Credit losses are identified when we do not expect to receive cash flows sufficient to recover the amortized cost basis of a security. In the event of a credit loss, only the amount associated with the credit loss is recognized in earnings, with the amount of loss relating to other factors recorded as a separate component of stockholders' equity.

#### *Goodwill*

The Company accounts for goodwill under ASC Topic 350, *Intangibles – Goodwill and Other*. Under the provisions of this guidance, goodwill and intangible assets with indefinite useful lives are not amortized but are subject to impairment tests based on their estimated fair value. Unamortized goodwill is continually reviewed for impairment in accordance with ASC. The Company performs its annual impairment assessment on the first day of the fourth quarter.

*Income Taxes*

We utilize ASC Topic 740, *Income Taxes*, which requires an asset and liability approach for financial accounting and reporting for income taxes. Under this guidance, deferred tax assets and liabilities are determined based upon differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax laws that will be in effect when the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. See Note 13 for further discussion of our accounting for income taxes.

Also under ASC Topic 740, *Income Taxes*, tax positions are evaluated for recognition using a more-than-likely-than-not threshold, and those tax positions requiring recognition are measured at the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. Liabilities for income tax matters include amounts for income taxes, applicable penalties, and interest thereon and are the result of the potential alternative interpretations of tax laws and the judgmental nature of the timing of recognition of taxable income.

### *Concentration of Credit Risks*

Our credit risks primarily relate to cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, marketable securities, restricted marketable securities and notes receivable. Cash and cash equivalents are primarily held in bank accounts and overnight investments. Restricted cash and cash equivalents is primarily invested in commercial paper and certificates of deposit with financial institutions and other interest bearing accounts. Accounts receivable consist primarily of amounts due from patients (funded through Medicare, Medicaid, other contractual programs and through private payors) and from other health care companies for management, accounting and other services. We perform continual credit evaluations of our clients and maintain allowances for doubtful accounts on these accounts receivable. Marketable securities and restricted marketable securities are held primarily in accounts with brokerage institutions. Notes receivable relate primarily to secured loans with health care facilities (recorded as notes receivable in the consolidated balance sheets) as discussed in Note 11.

At any point in time we have funds in our operating accounts and restricted cash accounts that are with third party financial institutions. These balances in the U.S. may exceed the Federal Deposit Insurance Corporation (FDIC) insurance limits. While we monitor the cash balances in our operating accounts, these cash and restricted cash balances could be impacted if the underlying financial institutions fail or could be subject to other adverse conditions in the financial markets.

Our financial instruments, principally our notes receivable, are subject to the possibility of loss of the carrying values as a result of the failure of other parties to perform according to their contractual obligations. We obtain various collateral and other protective rights, and continually monitor these rights in order to reduce such possibilities of loss. We evaluate the need to provide reserves for potential losses on our financial instruments based on management's periodic review of the portfolio on an instrument by instrument basis. See Note 11 for additional information on the notes receivable.

### *Cash and Cash Equivalents*

Cash equivalents include highly liquid investments with an original maturity of three months or less when purchased.

### *Restricted Cash and Cash Equivalents and Restricted Marketable Securities*

Restricted cash and cash equivalents and restricted marketable securities primarily represent assets that are held by our wholly-owned limited purpose insurance companies for workers' compensation and professional liability claims.

*Inventories*

Inventories consist generally of food and supplies and are valued at the lower of cost or market, with cost determined on a first-in, first-out (FIFO) basis.

*Other Current Liabilities*

Other current liabilities primarily represent accruals for current federal and state income taxes, real estate taxes and other current liabilities.

### *Accrued Risk Reserves*

We are principally self-insured for risks related to employee health insurance and utilize wholly-owned limited purpose insurance companies for workers' compensation and professional liability claims. Accrued risk reserves primarily represent the accrual for risks associated with employee health insurance, workers' compensation and professional liability claims. The accrued risk reserves include a liability for unpaid reported claims and estimates for incurred but unreported claims. Our policy with respect to a significant portion of our workers' compensation and professional and general liability claims is to use an actuary to estimate our exposure for claims obligation (for both asserted and unasserted claims). Our health insurance reserve is based on our known claims incurred and an estimate of incurred but unreported claims determined by our analysis of historical claims paid. We reassess our accrued risk reserves on a quarterly basis, with changes in estimated losses being recorded in the consolidated statements of income in the period first identified.

### *Stock-Based Compensation*

Stock-based awards granted include stock options, restricted stock units, and stock purchased under our employee stock purchase plan. Stock-based compensation cost is measured at the grant date, based on the fair value of the awards, and is recognized as expense over the requisite service period only for those equity awards expected to vest.

The fair value of the restricted stock units is determined based on the stock price on the date of grant. We estimated the fair value of stock options and stock purchased under our employee stock purchase plan using the Black-Scholes model. This model utilizes the estimated fair value of common stock and requires that, at the date of grant, we use the expected term of the grant, the expected volatility of the price of our common stock, risk-free interest rates and expected dividend yield of our common stock. The fair value is amortized on a straight-line basis over the requisite service periods of the awards.

### *Other Noncurrent Liabilities*

Other noncurrent liabilities include reserves primarily related to various uncertain income tax positions (see Note 13).

### *Deferred Revenue*

Deferred revenue includes the deferred gain on the sale of assets to National (as discussed in Note 3), certain amounts related to episodic payments received by our home health care providers in advance of providing services (as discussed in Note 1) and entrance fees that have been and are currently being received upon reservation and

occupancy of retirement center units for a continuing care retirement community we own. In accordance with ASC Topic 954-430, *Health Care Entities – Deferred Revenue*, the estimated amount of entrance fees that are expected to be refunded to current residents should be recorded as deferred revenue. According to our entrance fee contracts, a portion of the entrance fees are refundable (90%) only after a contract holder's unit has been resold. The amounts received from new residents in excess of the amounts to be paid to previous residents are deferred and amortized over the estimated life of the facility. The non-refundable portion (10%) is being recognized over the remaining life expectancies of the residents.

#### *Comprehensive Income*

ASC Topic 220, *Comprehensive Income*, requires that changes in the amounts of certain items, including unrealized gains and losses on marketable securities, be shown in the consolidated financial statements as comprehensive income. We report comprehensive income in the consolidated statements of comprehensive income and also in the consolidated statements of stockholders' equity.



### *Segment Disclosures*

ASC Topic 280, *Segment Reporting*, establishes standards for the way that public business enterprises report information about operating segments in annual and interim financial reports issued to stockholders. Management believes that substantially all of our operations are part of the long-term health care industry segment. See Note 4 for a detail of other revenues provided within the long-term health care industry segment. Information about the costs and expenses associated with each of the components of other revenues is not separately identifiable.

### *New Accounting Pronouncements*

In September 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011–08, which is included in the Codification under ASC 350, “Intangibles – Goodwill and Other.” The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a “qualitative” assessment to determine whether further impairment testing is necessary. This accounting standard update became effective beginning in our first quarter of fiscal 2012. The adoption did not have a material impact on the Company’s consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011–05, which is included in Codification under ASC 220, “Comprehensive Income”. This accounting standard update eliminates the option to present components of other comprehensive income as part of the statement of equity and requires the total of comprehensive income, the components of net income, and the components of other comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. It also requires presentation on the face of the financial statements of reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. This accounting standard update became effective beginning in our first quarter of fiscal 2012. In December 2011, the FASB issued ASU No. 2011–12 which indefinitely defers the guidance related to the presentation of reclassification adjustments only. The adoption of this accounting standard update resulted in financial statement presentation changes only.

In May 2011, the FASB issued ASU No. 2011–04, which is included in the Codification under ASC 820, “Fair Value Measurement.” The amendments in this update result in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments became effective beginning in our first fiscal quarter of 2012. The adoption did not have a material impact on the Company’s consolidated financial statements.

### *Reclassifications*

Certain prior period amounts have been reclassified to conform to the current financial statement presentation, with no effect on the Company's consolidated financial position or results of operations.

**Note 2 - Relationship with National Health Investors, Inc.**

In 1991, we formed National Health Investors, Inc. ("NHI") as a wholly-owned subsidiary. We then transferred to NHI certain healthcare facilities owned by NHC and distributed the shares of NHI to NHC's stockholders. The distribution had the effect of separating NHC and NHI into two independent public companies. As a result of the distribution, all of the outstanding shares of NHI were distributed to the then NHC investors. NHI is listed on the New York Stock Exchange under the symbol NHI.

*Leases*

On October 17, 1991, concurrent with our conveyance of real property to NHI, we leased from NHI the real property of certain health care centers. At December 31, 2012, we lease the real property of 38 long-term health care centers, six assisted living centers and three independent living centers. As part of our lease with NHI, we sublease four Florida long-term care centers to four separate corporations, none of which we own or control.

A 15-year lease extension began on January 1, 2007, and included three additional five-year renewal options, each at fair market value. On December 26, 2012, we extended the lease agreement through the first of the three additional five-year renewal options; therefore, extending the master lease date through 2026 and the two additional five-year renewal options still remain. Under the terms of the lease, base rent for 2007 totaled \$33,700,000 with rent thereafter escalating by 4% of the increase in facility revenue over a 2007 base year. The percentage rent is based on a quarterly calculation of revenue increases and is payable on a quarterly basis. Percentage rent expense for 2012, 2011, and 2010 was approximately \$2,591,000, \$2,969,000, and \$1,122,000, respectively.

Each lease with NHI is a "triple net lease" under which we are responsible for paying all taxes, utilities, insurance premium costs, repairs and other charges relating to the ownership of the facilities. We are obligated at our expense to maintain adequate insurance on the facilities' assets.

We have a right of first refusal with NHI to purchase any of the properties transferred from us should NHI receive an offer from an unrelated party during the term of the lease or up to 180 days after termination of the related lease.

Base rent expense to NHI was \$33,700,000 in 2012. At December 31, 2012, the approximate future minimum base rent to be paid by us on non-cancelable operating leases with NHI are as follows:

	Total	Total
	Commitments	Commitments
	Including	Excluding
	Florida Facilities	Florida Facilities
2013	\$ 33,700,000	\$ 28,948,000
2014	33,700,000	28,948,000
2015	33,700,000	28,948,000
2016	33,700,000	33,700,000
2017	33,700,000	33,700,000

Thereafter	303,300,000	303,300,000
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*Investment in NHI Common Stock*

At December 31, 2012 and 2011, we own 1,630,642 shares (or 5.9%) of NHI's outstanding common stock. We account for our investment in NHI common stock as available for sale marketable securities in accordance with the provisions of ASC Topic 320, *Investments*.

**Note 3 - Relationship with National Health Corporation**

National Health Corporation, which is wholly-owned by the National Health Corporation Leveraged Employee Stock Ownership Plan ("ESOP"), was formed in 1986 and is our administrative services affiliate and contractor. As discussed below, all of the personnel conducting our business, including our executive management team, are employees of National and have ownership interests in National only through their participation as employees in the ESOP.

### *Management Contracts*

We currently manage five long-term health care centers for National under a management contract. We manage the centers for management fees that are comparable to those in the industry. The management contract has been extended until January 1, 2018. See Note 4 for additional information regarding management fees recognized from National.

### *Financing Activities*

During 1991, we borrowed \$10,000,000 from National. The term note payable currently requires quarterly interest payments at the prime rate minus .85 percent. The entire principal is due at maturity in 2018.

In conjunction with our management contract, we have entered into a line of credit arrangement whereby we may have amounts due from National from time to time. The maximum loan commitment under the line of credit is \$2,000,000. The interest rate on the line of credit is prime plus one percent and the final maturity is January 20, 2018. At December 31, 2012, National did not have an outstanding balance on the line of credit.

The maximum line of credit commitment amount of \$2,000,000 is also the amount of a deferred gain that has been outstanding since NHC sold certain assets to National in 1988. The amount of the deferred gain is expected to remain deferred until the management contract with National expires, currently scheduled in January 2018. The deferred gain is included in deferred revenue in the consolidated balance sheets.

### *Payroll and Related Services*

The personnel conducting our business, including our executive management team, are employees of National and have ownership interests in National only through their participation in the ESOP. National provides payroll services to NHC, provides employee fringe benefits, and maintains certain liability insurance. We pay to National all the costs of personnel employed for our benefit, as well as an administrative fee equal to 1% of payroll costs. Such costs of personnel totaling approximately \$426,934,000, \$428,672,000, and \$400,270,000 for 2012, 2011 and 2010 respectively, are reflected as salaries, wages and benefits in the accompanying consolidated statements of income. The administrative fee paid to National for 2012, 2011, and 2010 was \$3,862,000, \$3,608,000, and \$3,299,000, respectively. National owes us \$5,149,086 and \$6,933,000 at December 31, 2012 and 2011, respectively, as a result of the differences between interim payments for payroll and benefits services costs made during the current and previous years and such actual costs. The amounts are included in accounts receivable in the consolidated balance sheets.

*National's Ownership of Our Stock*

At December 31, 2012 and 2011, National owns 1,271,147 shares (or approximately 9.0%) of our outstanding common stock and 1,271,147 shares (or approximately 11.7%) of our outstanding preferred stock.

*Consolidation Considerations*

Because of the contractual and management relationships between NHC and National as described in this note above, we have considered whether National should be consolidated by NHC under the guidance provided in ASC Topic 810, *Consolidation*. We do not consolidate National because (1) NHC does not have any obligation or rights (current or future) to absorb losses or to receive benefits from National. The ESOP participants bear the current and future financial gain or burden of National, (2) National's equity at risk is sufficient to finance its activities without past or future subordinated support from NHC or other parties, and (3) the equity holders of National (that is collectively the ESOP, its trustees, and the ESOP participants) possess the characteristics of a controlling financial interest, including voting rights that are proportional to their economic interests. Supporting

the assertions above is the following: (1) substantive independent trustees are appointed for the benefit of the ESOP participants when decisions must be made that may create the appearance of a conflict of interest between NHC and the ESOP, and (2) National was designed, formed and is operated for the purpose of creating variability and passing that variability along to the ESOP participants—that is, to provide retirement benefits and value to the employees of NHC and NHC’s affiliates. The contractual and management relationships between NHC and National are with certain nursing centers that are substantially less than 50% of the fair value of the total assets of National. NHC does not have a variable interest in National as a whole.

#### Note 4 - Other Revenues

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

	Year Ended December 31,		
	2012	2011	2010
		(in thousands)	
Insurance services	\$ 15,671	\$ 15,657	\$ 17,068
Management and accounting service fees	20,042	21,601	20,897
Rental income	19,039	19,124	17,375
Other	1,124	1,666	1,684
	\$ 55,876	\$ 58,048	\$ 57,024

#### *Management Fees from National*

We have managed long-term care centers for National since 1988, and we currently manage five centers. See Note 3 regarding our relationship with National.

During 2012, 2011 and 2010, National paid and we recognized approximately \$3,397,000, \$3,539,000, and \$3,982,000, respectively, of management fees and interest on management fees, which amounts are included in management and accounting service fees. Unrecognized and unpaid management fees from National total \$21,333,000, \$21,289,000, and \$21,320,000 at December 31, 2012, 2011 and 2010, respectively. We have recognized approximately \$37,621,000 of management fees and interest from these centers since 1988.

The unpaid fees from these five centers, because the amount collectable could not be reasonably determined when the management services were provided, and because we cannot estimate the timing or amount of expected future collections, will be recognized as revenues only when 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 centers or proceeds from the sale of the centers are sufficient to pay the fees. There can be no assurance that such future improved cash flows will occur.



*Management Fees from Other Nursing Centers*

We continue to manage fourteen long-term health centers (excluding the five National centers) for third-party owners where the management fees are recognized only when realized. During 2012, 2011, and 2010, we recognized \$5,660,000, \$6,138,000, and \$4,753,000, respectively, of management fees and interest from these fourteen long-term care centers. Unrecognized and unpaid management fees from these centers total \$8,505,000, \$8,502,000, and \$8,889,000 at December 31, 2012, 2011, and 2010, respectively. We have recognized approximately \$39,807,000 of management fees and interest from these centers since 2002.

The unpaid fees from these fourteen centers, because of insufficient historical collections and the lack of expected future collections, will be recognized as revenues only when the collectability of the fees can be reasonably assured.

Under the terms of our management agreements, the payment of these fees to us may be subordinated to other expenditures of each of the long-term care providers. 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 and uncollected management fees in whole or in part in the future only if cash flows from 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 improved cash flows will occur.

During 2012, a receiver was appointed for the fourteen long-term health centers and the Board of Directors' of the respective two nonprofit organizations no longer have the custodial responsibility over the assets of the entities.

Consequently, the appointed receiver for each of the two nonprofit organizations filed a lawsuit against us and another party. As stated above, we are currently managing the fourteen facilities and have a management contract with the receiver, but it is unknown at this time how long we will continue to manage the health care centers or the receiver's intentions. However, if we no longer manage some or all of the fourteen health care centers, such impact may be adverse and material to our future results of operations and cash flows. See Note 15 for additional information on the pending litigation.

*Rental Income*

In 2007, NHC acquired all of the net assets of National Health Realty, Inc., which was a health care real estate investment trust. The properties acquired in the acquisition are the properties that have generated the majority of the rental income for NHC for the years ended December 31, 2012, 2011, and 2010. The health care properties currently owned and leased to third party operators include nine skilled nursing facilities and four assisted living communities. We renewed the rental agreements in 2011 for a five year period, which ends on December 31, 2015.

**Note 5 – Non-Operating Income**

Non-operating income is outlined in the table below. Non-operating income includes equity in earnings of unconsolidated investments, dividends and other realized gains and losses on securities, interest income, and other miscellaneous non-operating income. Our most significant equity method investment is a 75.1% non-controlling ownership interest in Caris, a business that specializes in hospice care services. See Note 16 for additional disclosures regarding Caris.

	2012	Year Ended December 31, 2011 <i>(in thousands)</i>	2010
Equity in earnings of unconsolidated investments	\$ 13,616	\$ 9,674	\$ 8,993
Dividends and net realized gains on sales of securities	7,006	5,875	5,404
Interest income	4,623	4,984	5,380
Recovery of assets in acquisition of healthcare centers	—	—	3,563
	\$ 25,245	\$ 20,533	\$ 23,340

**Note 6 – Other Operating Expenses**

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

**Note 7 - Earnings Per Share**

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

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

	Year Ended December 31,		
	2012	2011	2010
	<i>(dollars in thousands, except share and per share amounts)</i>		
<b>Basic:</b>			
Weighted average common shares outstanding	13,852,709	13,774,628	13,671,053
Net income	\$ 57,957	\$ 64,072	\$ 52,695
Dividends to preferred stockholders	8,671	8,671	8,673
Net income available to common stockholders	\$ 49,286	\$ 55,401	\$ 44,022
Earnings per common share, basic	\$ 3.56	\$ 4.02	\$ 3.22
<b>Diluted:</b>			
Weighted average common shares outstanding	13,852,709	13,774,628	13,671,053
Dilutive effect of stock options	8,019	9,934	3,237
Dilutive effect of restricted stock	5,526	6,009	2,186
Dilutive effect of contingent issuable stock	109,233	–	–
Convertible preferred stock	2,623,329	2,623,452	–
	16,598,816	16,414,023	13,676,476

Assumed average common shares  
outstanding

Net income available to common stockholders	\$	49,286	\$	55,401	\$	44,022
Add dilutive preferred stock dividends for effect of assumed conversion of preferred stock		8,671		8,671		–
Net income for diluted earnings per common share	\$	57,957	\$	64,072	\$	44,022
Earnings per common share, diluted	\$	3.49	\$	3.90	\$	3.22

Excluded in the above table are 1,068,302; 1,420,620; and 235,620 shares associated with stock options for 2012, 2011, and 2010, respectively, due to their antidilutive impact. Also excluded in 2010 are 2,623,861 potential common shares issuable upon the conversion of preferred stock due to their antidilutive impact.

**Note 8 - Investments in Marketable Securities**

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

	December 31, 2012		December 31, 2011	
	Amortized	Fair	Amortized	Fair
<i>(in thousands)</i>	Cost	Value	Cost	Value
Investments available for sale:				
Marketable equity securities	\$ 30,176	\$ 107,250	\$ 30,176	\$ 85,051
Restricted investments available for sale:				
Corporate debt securities	61,453	62,876	33,426	34,074
Commercial mortgage-backed securities	47,194	48,063	33,275	33,904
U.S. Treasury securities	16,218	16,604	7,778	8,070
State and municipal securities	7,213	7,664	7,270	7,577
	\$ 162,254	\$ 242,457	\$ 111,925	\$ 168,676

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

*(in thousands, except share amounts)*

	December 31, 2012			December 31, 2011		
	Shares	Cost	Fair Value	Shares	Cost	Fair Value
NHI Common Stock	1,630,642	\$ 24,734	\$ 92,180	1,630,642	\$ 24,734	\$ 71,716

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

<i>(in thousands)</i>	December 31, 2012		December 31, 2011	
	Cost	Fair Value	Cost	Fair Value
Maturities:				

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Within 1 year	\$ 8,868	\$ 8,918	\$ 5,280	\$ 5,298
1 to 5 years	80,910	82,801	44,923	45,734
6 to 10 years	40,670	41,856	21,993	22,768
Over 10 years	1,630	1,632	9,553	9,825
	\$ 132,078	\$ 135,207	\$ 81,749	\$ 83,625

Gross unrealized gains related to available for sale securities are \$80,296,000 and \$57,138,000 as of December 31, 2012 and 2011, respectively. Gross unrealized losses related to available for sale securities were \$93,000 and \$387,000 as of December 31, 2012 and 2011, respectively.

Proceeds from the sale of investments in marketable securities during the years ended December 31, 2012, 2011 and 2010 were \$62,649,000, \$46,266,000, and \$43,849,000, respectively. Net investment gains of \$1,640,000, \$754,000, and \$891,000 were realized on these sales during the years ended December 31, 2012, 2011, and 2010, respectively.

## Note 9 – Fair Value Measurements

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

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

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

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

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

### *Valuation of Marketable Securities*

The Company determines fair value for marketable securities with Level 1 inputs through quoted market prices. The Company determines fair value for marketable securities with Level 2 inputs through broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. Our Level 2 marketable securities have been initially valued at the transaction price and subsequently valued, at the end of each month, typically utilizing third party pricing services or other market observable data. The pricing services utilize industry standard valuation models, including both income and market based approaches and observable market inputs to determine value. These observable market inputs include reportable trades, benchmark yields, credit spreads, broker/dealer quotes, bids, offers, and other industry and economic events.

We validated the prices provided by our broker by reviewing their pricing methods, obtaining market values from other pricing sources, analyzing pricing data in certain instances and confirming that the relevant markets are active.

After completing our validation procedures, we did not adjust or override any fair value measurements provided by our broker as of December 31, 2012 or 2011. We did not have any transfers of assets between Level 1 and Level 2 of the fair value measurement hierarchy during the twelve months ended December 31, 2012 or 2011.

*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. At December 31, 2012 and 2011, 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 December 31, 2012 and December 31, 2011 for assets and liabilities measured at fair value on a recurring basis (*in thousands*):

	Fair Value Measurements Using				
	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
December 31, 2012					
Cash and cash equivalents	\$ 66,701	\$ 66,701	\$ —	\$ —	—
Restricted cash and cash equivalents	11,563	11,563	—	—	—
Marketable equity securities	107,250	107,250	—	—	—
Corporate debt securities	62,876	—	62,876	—	—
Commercial mortgage-backed securities	48,063	—	48,063	—	—
U.S. Treasury securities	16,604	16,604	—	—	—
State and municipal securities	7,664	—	7,664	—	—
Total financial assets	\$ 320,721	\$ 202,118	\$ 118,603	\$ —	—

	Fair Value Measurements Using				
	Fair Value	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
December 31, 2011					
Cash and cash equivalents	\$ 61,008	\$ 61,008	\$ —	\$ —	—
Restricted cash and cash equivalents	50,587	50,587	—	—	—
Marketable equity securities	85,051	85,051	—	—	—
Corporate debt securities	34,074	—	34,074	—	—
	33,904	—	33,904	—	—

Commercial mortgage-backed securities					
U.S. Treasury securities	8,070		8,070	–	–
State and municipal securities	7,577		–	7,577	–
Total financial assets	\$ 280,271	\$	204,716	\$ 75,555	–

**Note 10 - Property and Equipment**

Property and equipment, at cost, consists of the following:

	2012	December 31, <i>(in thousands)</i>	2011
Land	\$ 50,711		\$ 47,195
Leasehold improvements	90,925		88,204
Buildings and improvements	396,228		390,973
Furniture and equipment	126,288		123,613
Construction in progress	11,303		9,538
	675,455		659,523
Less: Accumulated depreciation	(254,548)		(229,872)
	\$ 420,907		\$ 429,651

**Note 11 - Notes Receivable**

At December 31, 2012 and 2011, we have notes receivable from managed and other long-term health care centers totaling \$21,789,000 and \$22,449,000, respectively, reflected in the accompanying consolidated balance sheets. The notes are first and second mortgages with interest rates ranging from prime plus 2% to 10.5% fixed rate with periodic payments required prior to maturity. The notes mature in the years from 2013 through 2016. The proceeds of the notes were used by the long-term health care centers for construction costs, development costs incurred during construction, and working capital.

**Note 12 - Long-Term Debt***Long-Term Debt*

Long-term debt consists of the following (*dollars in thousands*):

	Weighted Average Interest Rate	Maturities	December 31,	
	Variable,		2012	2011
Revolving Credit Facility, interest payable monthly	0.9%	2013	\$ -	\$ -
Unsecured term note payable to National, interest payable quarterly, principal payable at maturity	Variable, 2.8%	2018	10,000 10,000	10,000 10,000
Less current portion			\$ - 10,000	\$ - 10,000

*\$75,000,000 Revolving Credit Agreement*

Effective October 24, 2012, 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 base rate. Letter of credit fees are equal to 0.70% times the maximum amount available to be drawn under outstanding letters of credit. The rates and fees are unchanged from those in effect prior to the extension.

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

The Credit Facility matures on October 23, 2013. Between 90 and 120 days prior to the maturity date, NHC may request the extension of the maturity date. If the Lender elects to consent to such extension, subject to certain conditions, the maturity date will be extended to the date which is 364 days after the then maturity date.

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

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

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

The aggregate maturities of long-term debt for the five years subsequent to December 31, 2012 are as follows:

	Long-Term	
	Debt	
	<i>(in thousands)</i>	
2013	\$	—
2014		—
2015		—
2016		—
2017		—
Thereafter		10,000
Total	\$	10,000

**Note 13 - Income Taxes**

The provision for income taxes is comprised of the following components:

	2012	Year Ended December 31,	
		2011	2010
		<i>(in thousands)</i>	
Current Tax Provision			
Federal	\$ 29,147	\$ 29,311	\$ 23,734
State	4,010	3,131	2,953
	33,157	32,442	26,687
Deferred Tax Provision			
Federal	162	1,220	1,386
State	4	145	199
	166	1,365	1,585
Income Tax Provision	\$ 33,323	\$ 33,807	\$ 28,272

The deferred tax assets and liabilities, consisting of temporary differences tax effected at the respective income tax rates, are as follows:

	December 31,	
	2012	2011
	<i>(in thousands)</i>	
Current deferred tax asset:		
Allowance for doubtful accounts receivable	\$ 1,022	\$ 1,174
Accrued expenses	7,490	7,946
	8,512	9,120
Current deferred tax liability:		
Unrealized gains on marketable securities	(31,154)	(22,058)
Other	(1,832)	(1,588)
	(32,986)	(23,646)
Net current deferred tax liability	\$ (24,474)	\$ (14,526)
Noncurrent deferred tax asset:		
Financial reporting depreciation in excess of tax depreciation	\$ 4,086	\$ 968
Deferred gain on sale of assets (net)	(3,135)	(3,135)
Tax basis intangible asset in excess of financial reporting basis	663	968
Stock-based compensation	1,682	1,283
Long-term investments	(1,387)	157
Accrued expenses	2,132	2,129
Deferred revenue	6,523	7,797
Net noncurrent deferred tax asset	\$ 10,564	10,167





A reconciliation of income tax expense and the amount computed by applying the statutory federal income tax rate to income before income taxes is as follows:

	Year Ended December 31,		
	2012	2011	2010
		<i>(in thousands)</i>	
Tax provision at federal statutory rate	\$ 31,948	\$ 34,258	\$ 28,338
Increase (decrease) in income taxes			
resulting from:			
State, net of federal benefit	3,173	3,185	2,897
Nondeductible expenses	118	188	169
Insurance expense	39	26	(133)
Other, net	823	57	62
Unrecognized tax benefits	409	85	660
Expiration of statute of limitations	(3,187)	(3,992)	(3,721)
	1,375	(451)	(66)
Effective income tax expense	\$ 33,323	\$ 33,807	\$ 28,272

The exercise of non-qualified stock options results in state and federal income tax benefits to the Company related to the difference between the market price at the date of exercise and the option exercise price. During 2012, 2011 and 2010, \$(267,000), \$(52,000), and \$154,000, respectively, attributable to the tax benefit of stock options exercised and restricted stock, was credited to additional paid-in capital.

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 adequate provisions 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.

Also under ASC Topic 740, tax positions are evaluated for recognition using a more-likely-than-not threshold, and those tax positions requiring recognition are measured at the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant

information.

In accordance with current guidance, the Company has established a liability for unrecognized tax benefits, which are differences between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to this Interpretation. Generally a liability is created for an unrecognized tax benefit because it represents a company's potential future obligation to a taxing authority for a tax position that was not recognized per above.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	Deferred Tax Asset	Liability For Unrecognized Tax Benefits	Liability For Interest and Penalties	Liability Total
Balance, January 1, 2010	\$ 11,894	\$ 17,275	\$ 5,358	\$ 22,633
Additions based on tax positions related to the current year	–	1,094	144	1,238
Reductions for tax positions of prior years	(1,510)	(1,356)	67	(1,289)
Reductions for statute of limitation expirations	(295)	(2,502)	(1,219)	(3,721)
Balance, December 31, 2010	10,089	14,511	4,350	18,861
Additions based on tax positions related to the current year	–	1,452	183	1,635
Additions for tax positions of prior years	(70)	189	(449)	(260)
Reductions for statute of limitation expirations	(93)	(2,387)	(1,605)	(3,992)
Balance, December 31, 2011	9,926	13,765	2,479	16,244
Additions based on tax positions related to the current year	–	1,695	185	1,880
Additions for tax positions of prior years	728	845	170	1,015
Reductions for statute of limitation expirations	(1,999)	(4,309)	(940)	(5,249)
Balance, December 31, 2012	\$ 8,655	\$ 11,996	\$ 1,894	\$ 13,890

During the year ended December 31, 2012, we have recognized a \$4,309,000 decrease in unrecognized tax benefits (including \$1,999,000 of temporary differences and \$2,310,000 of permanent differences) and an accompanying \$940,000 decrease of related interest and penalties due to the effect of statute of limitations lapse. The favorable impact on our tax provision was \$3,187,000 composed of \$2,310,000 tax and \$707,000 interest and penalties on permanent differences and \$170,000 interest and penalties on temporary differences.

At December 31, 2012, we had \$11,996,000 of unrecognized tax benefits, composed of \$8,292,000 of deferred tax assets and \$3,704,000 of permanent differences. Accrued interest and penalties of \$1,894,000 related to unrecognized tax benefits at December 31, 2012. Unrecognized tax benefits of \$3,704,000, net of federal benefit, at December 31, 2012, attributable to permanent differences, would favorably impact our effective tax rate if recognized. Accrued interest and penalties of \$1,531,000 relate to these permanent differences at December 31, 2012. We do not expect to recognize significant increases or decreases in unrecognized tax benefits within the twelve months beginning December 31, 2012, except for the effect of decreases related to the lapse of statute of limitations estimated at \$2,707,000, composed of temporary differences of \$1,722,000, and permanent differences of \$985,000. Interest and

penalties of \$602,000 relate to these temporary and permanent difference changes within 12 months beginning December 31, 2012.

During the year ended December 31, 2011, we have recognized a \$2,387,000 decrease in unrecognized tax benefits (including \$0- of temporary differences and \$2,387,000 of permanent differences) and an accompanying \$1,605,000 decrease of related interest and penalties due to the effect of statute of limitations lapse. The favorable

impact on our tax provision was \$3,992,000 composed of \$2,387,000 tax and \$1,605,000 interest and penalties on permanent differences and \$-0- interest and penalties on temporary differences.

At December 31, 2011, we had \$13,765,000 of unrecognized tax benefits, composed of \$9,308,000 of deferred tax assets and \$4,457,000 of permanent differences. Accrued interest and penalties of \$2,479,000 related to unrecognized tax benefits at December 31, 2011. Unrecognized tax benefits of \$4,457,000, net of federal benefit, at December 31, 2011, attributable to permanent differences, would favorably impact our effective tax rate if recognized. Accrued interest and penalties of \$1,650,000 relate to these permanent differences at December 31, 2011.

During the year ended December 31, 2010, we have recognized a \$2,502,000 decrease in unrecognized tax benefits (including \$-0- of temporary differences and \$2,502,000 of permanent differences) and an accompanying \$1,219,000 decrease of related interest and penalties due to the effect of statute of limitations lapse. The favorable impact on our tax provision was \$3,721,000 composed of \$2,502,000 tax and \$1,219,000 interest and penalties on permanent differences and \$-0- interest and penalties on temporary differences.

At December 31, 2010, we had \$14,511,000 of unrecognized tax benefits, composed of \$9,048,000 of deferred tax assets and \$5,463,000 of permanent differences. Accrued interest and penalties of \$4,350,000 related to unrecognized tax benefits at December 31, 2010. Unrecognized tax benefits of \$5,463,000, net of federal benefit, at December 31, 2010, attributable to permanent differences, would favorably impact our effective tax rate if recognized. Accrued interest and penalties of \$1,931,000 relate to these permanent differences at December 31, 2010.

Interest and penalties expense related to U.S. federal and state income tax returns are included within income tax expense. Interest and penalties expense (benefit) was \$(585,000); \$(1,871,000); and \$(1,008,000); for the years ended December 31, 2012, 2011, and 2010, respectively.

The Company is no longer subject to U.S. federal and state examinations by tax authorities for years before 2009 (with few state exceptions). Currently, there are no U.S. federal and state returns under examination.

#### **Note 14 - Stock-Based Compensation**

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

*The 2005 and 2010 Stock-Based Compensation Plans*

The Compensation Committee of the Board of Directors ("the Committee") has the authority to select the participants to be granted options; to designate whether the option granted is an incentive stock option ("ISO"), a non-qualified option, or a stock appreciation right; to establish the number of shares of common stock that may be issued upon exercise of the option; to establish the vesting provision for any award; and to establish the term any award may be outstanding. The exercise price of any ISO's granted will not be less than 100% of the fair market value of the shares of common stock on the date granted and the term of an ISO may not be any more than ten years. The exercise price of any non-qualified options granted will not be less than 100% of the fair market value of the shares of common stock on the date granted unless so determined by the Committee.

In May 2005, our stockholders approved the 2005 Stock Option, Employee Stock Purchase, Physician Stock Purchase and Stock Appreciation Rights Plan ("the 2005 Plan") pursuant to which 1,200,000 shares of our common stock were available to grant as stock-based payments to key employees, directors, and non-employee consultants. At December 31, 2012, 145,620 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. At December 31, 2012, 470,732 shares were available for future grants under the 2010 Plan.

Under both the 2005 and 2010 Plans, the individual restricted stock and option grant awards vest over periods up to five years. The term of the options outstanding under both Plans is five years from the date of the grant. Our policy is to issue new shares to satisfy option exercises.

Additionally, we have an employee stock purchase plan that allows employees to purchase our shares of stock through payroll deductions. The plan allows employees to terminate participation at any time.

Compensation expense is recognized only for the awards that ultimately vest. Stock-based compensation totaled \$2,366,000, \$2,751,000, and \$321,000 for the years ended December 31, 2012, 2011, and 2010, respectively. The expense for the 2012 year consisted of \$2,159,000 for stock options and \$207,000 for restricted stock.

At December 31, 2012, we had \$5,878,000 of unrecognized compensation cost related to unvested stock-based compensation awards, which consisted of \$5,392,000 for stock options and \$486,000 for restricted stock. This expense will be recognized over the remaining weighted average vesting period, which is approximately 3.2 years for stock options and 1.3 years for restricted stock. Stock-based compensation is included in salaries, wages and benefits in the consolidated statements of income. Tax deductions for the options exercised and restricted stock vested totaled \$404,000, \$1,054,000, and \$691,000 for the years ended December 31, 2012, 2011, and 2010, respectively.

### *Stock Options*

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

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	Year Ended December 31,		
	2012	2011	2010
Risk-free interest rate	0.28%	2.02%	1.88%
Expected volatility	38.8%	23.7%	25.3%
Expected life, in years	2.1 years	4.8 years	4.5 years
Expected dividend yield	2.91%	3.62%	3.55%



The following table summarizes option activity:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value
Options outstanding at January 1, 2010	385,305	\$ 44.78	\$ —
Options granted	180,485	35.55	—
Options exercised	(72,149)	36.69	—
Options cancelled	(21,314)	32.01	—
Options outstanding at December 31, 2010	472,327	43.07	—
Options granted	1,264,719	46.58	—
Options exercised	(224,969)	37.30	—
Options cancelled	(30,000)	44.25	—
Options outstanding at December 31, 2011	1,482,077	46.92	—
Options granted	63,516	44.28	—
Options exercised	(295,371)	45.41	—
Options cancelled	(115,620)	50.99	—
Options outstanding at December 31, 2012	1,134,602	\$ 46.75	\$ 711,000
Options exercisable	197,602	\$ 47.03	\$ 402,000

Options		Weighted Average	
Outstanding		Weighted Average	Remaining Contractual
December 31,	Exercise Prices	Exercise Price	Life in Years
2012			
28,800	\$37.70	\$37.70	1.3
1,015,802	\$44.80 - \$46.69	\$46.58	3.2
90,000	\$51.50	\$51.50	0.3
1,134,602		\$46.75	3.0

At December 31, 2012, 197,602 options outstanding are exercisable. Exercise prices on the options range from \$37.70 to \$51.50. The weighted average remaining contractual life of all options outstanding at December 31, 2012 is 2.9 years. The total intrinsic value of shares exercised during the year ended December 31, 2012 was \$562,000.



*Restricted Stock*

The following table summarizes restricted stock activity:

		Weighted	
	Number of	Average Grant	Aggregate
	Shares	Date Fair	Intrinsic
		Value	Value
Unvested restricted shares at January 1, 2010	–	\$ –	–
Award shares granted	30,000	34.46	–
Award shares vested	–	–	–
Unvested restricted shares at December 31, 2010	30,000	34.46	–
Award shares granted	–	–	–
Award shares vested	6,000	34.46	–
Unvested restricted shares at December 31, 2011	24,000	34.46	–
Award shares granted	–	–	–
Award shares vested	6,000	34.46	–
Unvested restricted shares at December 31, 2012	18,000	\$ 34.46	\$ 226,000

The weighted average remaining contractual life of restricted stock at December 31, 2012 is 1.3 years.

**Note 15 - Contingencies and Guarantees***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 \$110,331,000 and \$98,732,000 at December 31, 2012 and 2011, respectively. This liability is classified as current based on the uncertainty regarding the timing of potential payments. The liability is included in accrued risk reserves in the consolidated balance sheets. The amounts are 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 would have a

material adverse effect on our financial position, results of operations and cash flows.

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

#### *Workers' Compensation*

For workers' compensation, we utilize a wholly-owned Tennessee domiciled property/casualty insurance company to write coverage for NHC affiliates and for third-party customers. Policies are written for a duration of twelve months and cover only risks related to workers' compensation losses. All customers are companies which operate in the long-term care industry. Business is written on a direct basis. For direct business, coverage is written for statutory limits and the insurance company's losses in excess of \$1,000,000 per claim are covered by reinsurance.

For these workers' compensation insurance operations, the premium revenues reflected in the consolidated financial statements as other revenues for 2012, 2011 and 2010, respectively, are \$5,438,000, \$4,910,000, and \$5,122,000. Associated losses and expense