AllianzGI Convertible & Income Fund II
Form N-Q
July 20, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-Q

QUARTERLY SCHEDULE OF PORTFOLIO HOLDINGS

OF REGISTERED MANAGEMENT INVESTMENT COMPANY

Investment Company Act file number 811-21338

AllianzGI Convertible & Income Fund II

(Exact name of registrant as specified in charter)

1633 Broadway, New York, NY 10019

(Address of principal executive offices) (Zip code)

Scott Whisten

1633 Broadway,

New York, NY 10019

(Name and address of agent for service)

Registrant s telephone number, including area code: 212-739-3367

Date of fiscal year end: February 28

Date of reporting period: May 31, 2018

Item 1. Schedule of Investments

Schedule of Investments

AllianzGI Convertible & Income Fund II

May 31, 2018 (unaudited)

Principal Amount (000s)		Value*
CORPORATE BONDS & NOTES 37.4%		
	Aerospace & Defense 1.0%	
$5,750	TransDigm, Inc., 6.50%, 5/15/25	$ 5,847,175
1,080	Triumph Group, Inc., 7.75%, 8/15/25	1,090,800
		6,937,975
	Auto Manufacturers 0.7%	
4,685	Navistar International Corp., 6.625%, 11/1/25 (a)(b)	4,860,687
	Building Materials 0.6%	
4,335	U.S. Concrete, Inc., 6.375%, 6/1/24	4,427,119
	Chemicals 3.1%	
5,500	Chemours Co., 6.625%, 5/15/23	5,783,415
3,640	Kraton Polymers LLC, 7.00%, 4/15/25 (a)(b)	3,767,400
2,890	Olin Corp., 5.00%, 2/1/30	2,723,969
4,330	Platform Specialty Products Corp., 6.50%, 2/1/22 (a)(b)	4,449,075
810	Tronox Finance PLC, 5.75%, 10/1/25 (a)(b)	787,725
4,180	Tronox, Inc., 6.50%, 4/15/26 (a)(b)	4,132,975
		21,644,559
	Commercial Services 0.4%	
5,974	Cenveo Corp., 6.00%, 5/15/24, (a)(b)(c)(h) (acquisition cost-$8,347,108; purchased 3/22/12)	328,570
2,500	United Rentals North America, Inc., 5.50%, 7/15/25	2,540,625
		2,869,195
	Computers 1.4%	
3,946	DynCorp International, Inc., PIK 1.50%, 11.875%, 11/30/20	4,143,550
5,650	Harland Clarke Holdings Corp., 9.25%, 3/1/21 (a)(b)	5,664,125
		9,807,675
	Distribution/Wholesale 0.6%	
4,110	H&E Equipment Services, Inc., 5.625%, 9/1/25	4,074,038
	Diversified Financial Services 3.4%	

	Community Choice Financial, Inc.,	
7,465	10.75%, 5/1/19	5,785,375
5,370	12.75%, 5/1/20 (a)(b)	3,248,850
	Nationstar Mortgage LLC,	
2,000	7.875%, 10/1/20	2,033,000
4,250	9.625%, 5/1/19	4,314,812
1,200	Navient Corp., 7.25%, 9/25/23	1,269,000
3,865	Springleaf Finance Corp., 8.25%, 10/1/23	4,222,513
2,730	Travelport Corporate Finance PLC, 6.00%, 3/15/26 (a)(b)	2,750,475
		23,624,025
	Electric Utilities 0.6%	
4,265	NRG Energy, Inc., 6.25%, 5/1/24	4,424,937
	Engineering & Construction 0.8%	
2,165	AECOM, 5.125%, 3/15/27	2,013,450
3,900	Tutor Perini Corp., 6.875%, 5/1/25 (a)(b)	3,937,830
		5,951,280
	Entertainment 1.0%	
3,810	AMC Entertainment Holdings, Inc., 6.125%, 5/15/27	3,693,795
3,045	Cedar Fair L.P., 5.375%, 6/1/24	3,067,837
		6,761,632
	Healthcare-Services 2.4%	
1,880	Centene Escrow I Corp., 5.375%, 6/1/26 (a)(b)	1,903,500
2,165	Community Health Systems, Inc., 6.25%, 3/31/23	2,029,688
4,125	DaVita, Inc., 5.125%, 7/15/24	4,029,609
2,950	Envision Healthcare Corp., 6.25%, 12/1/24 (a)(b)	3,127,590
2,950	HCA, Inc., 7.50%, 2/15/22	3,222,875
2,750	Tenet Healthcare Corp., 7.00%, 8/1/25 (a)(b)	2,743,125
		17,056,387

Schedule of Investments

AllianzGI Convertible & Income Fund II

May 31, 2018 (unaudited) (continued)

Principal Amount (000s)		Value*
	Home Builders 0.5%	
$3,365	Beazer Homes USA, Inc., 8.75%, 3/15/22	$ 3,608,963
	Internet 0.3%	
2,200	Netflix, Inc., 5.875%, 2/15/25	2,268,970
	Iron/Steel 0.7%	
	AK Steel Corp.,	
1,550	7.00%, 3/15/27	1,488,000
1,005	7.50%, 7/15/23	1,061,531
2,165	United States Steel Corp., 6.875%, 8/15/25	2,224,971
		4,774,502
	Lodging 0.3%	
2,165	Wynn Las Vegas LLC, 5.50%, 3/1/25 (a)(b)	2,127,113
	Machinery-Construction & Mining 0.5%	
3,585	Terex Corp., 5.625%, 2/1/25 (a)(b)	3,562,594
	Media 2.1%	
5,630	Cablevision Systems Corp., 8.00%, 4/15/20	5,953,725
2,850	Gray Television, Inc., 5.875%, 7/15/26 (a)(b)	2,700,375
3,589	LiveStyle, Inc., 9.625%, 2/1/19 (a)(b)(c)(f)(h)(j) (acquisition cost -$3,749,795; purchased 5/7/14-2/26/15)	72
5,512	McClatchy Co., 9.00%, 12/15/22	5,746,260
		14,400,432
	Metal Fabricate/Hardware 0.4%	
2,920	Park-Ohio Industries, Inc., 6.625%, 4/15/27	3,014,900
	Mining 1.9%	
3,900	Alcoa Nederland Holding BV, 7.00%, 9/30/26 (a)(b)	4,221,750
3,365	Constellium NV, 6.625%, 3/1/25 (a)(b)	3,360,794
2,135	Hudbay Minerals, Inc., 7.625%, 1/15/25 (a)(b)	2,252,425
3,050	Joseph T. Ryerson & Son, Inc., 11.00%, 5/15/22 (a)(b)	3,370,250
		13,205,219
	Miscellaneous Manufacturing 0.3%	
2,255	Koppers, Inc., 6.00%, 2/15/25 (a)(b)	2,291,644

	Oil, Gas & Consumable Fuels 3.3%	
2,300	Calumet Specialty Products Partners L.P., 6.50%, 4/15/21	2,274,125
1,420	Carrizo Oil & Gas, Inc., 6.25%, 4/15/23	1,444,850
	Ensco PLC,	
450	5.20%, 3/15/25	378,563
2,400	7.75%, 2/1/26	2,295,000
6,180	EP Energy LLC, 9.375%, 5/1/20	6,056,400
2,165	NGL Energy Partners L.P., 7.50%, 11/1/23	2,216,419
740	Noble Holding International Ltd., 7.75%, 1/15/24	697,450
3,745	Oasis Petroleum, Inc., 6.875%, 3/15/22	3,810,537
3,470	Sanchez Energy Corp., 6.125%, 1/15/23	2,298,875
1,280	Transocean, Inc., 7.50%, 1/15/26 (a)(b)	1,300,800
630	Weatherford International Ltd., 8.25%, 6/15/23	612,675
		23,385,694
	Pharmaceuticals 1.3%	
1,755	Endo Finance LLC, 5.375%, 1/15/23 (a)(b)	1,311,862
4,425	Horizon Pharma, Inc., 6.625%, 5/1/23	4,469,250
3,000	Valeant Pharmaceuticals International, Inc., 7.50%, 7/15/21 (a)(b)	3,067,500
		8,848,612
	Pipelines 0.4%	
2,715	Energy Transfer Equity L.P., 5.50%, 6/1/27	2,759,119
	Real Estate 1.1%	
3,500	Kennedy-Wilson, Inc., 5.875%, 4/1/24	3,456,250
4,090	Uniti Group L.P., 8.25%, 10/15/23	4,006,973
		7,463,223
	Retail 1.4%	
4,370	Conn s, Inc., 7.25%, 7/15/22	4,315,375
1,170	L Brands, Inc., 6.875%, 11/1/35	1,069,087
5,785	Neiman Marcus Group Ltd. LLC, 8.00%, 10/15/21 (a)(b)	4,165,200
		9,549,662

Schedule of Investments

AllianzGI Convertible & Income Fund II

May 31, 2018 (unaudited) (continued)

Principal Amount (000s)		Value*
	Semiconductors 1.0%	
$4,090	Advanced Micro Devices, Inc., 7.00%, 7/1/24	$ 4,325,175
2,875	Amkor Technology, Inc., 6.375%, 10/1/22	2,947,162
		7,272,337
	Software 0.7%	
3,850	Camelot Finance S.A., 7.875%, 10/15/24 (a)(b)	3,955,875
1,135	Rackspace Hosting, Inc., 8.625%, 11/15/24 (a)(b)	1,157,700
		5,113,575
	Telecommunications 4.6%	
865	CenturyLink, Inc., 7.50%, 4/1/24, Ser. Y	890,950
3,125	Cincinnati Bell, Inc., 7.00%, 7/15/24 (a)(b)	2,812,500
7,130	Consolidated Communications, Inc., 6.50%, 10/1/22	6,666,550
4,045	Frontier Communications Corp., 10.50%, 9/15/22	3,660,725
2,050	GTT Communications, Inc., 7.875%, 12/31/24 (a)(b)	2,060,250
	Hughes Satellite Systems Corp.,	
1,130	6.625%, 8/1/26	1,101,750
3,500	7.625%, 6/15/21	3,745,000
5,545	Sprint Communications, Inc., 11.50%, 11/15/21	6,556,962
1,425	Sprint Corp., 7.625%, 3/1/26	1,467,750
6,283	Windstream Services LLC, 6.375%, 8/1/23 (a)(b)	3,675,555
		32,637,992
	Transportation 0.6%	
3,920	XPO Logistics, Inc., 6.50%, 6/15/22 (a)(b)	4,028,780
	Total Corporate Bonds & Notes (cost-$281,057,763)	262,752,840
CONVERTIBLE BONDS & NOTES 30.9%		
	Apparel & Textiles 1.2%	
11,020	Iconix Brand Group, Inc., 5.75%, 8/15/23	8,126,324
	Auto Components 1.0%	
8,945	Horizon Global Corp., 2.75%, 7/1/22	6,949,147
	Auto Manufacturers 1.3%	
4,675	Navistar International Corp., 4.75%, 4/15/19	4,838,550
	Tesla, Inc.,	

1,785	0.25%, 3/1/19	1,806,716
2,150	1.25%, 3/1/21	2,171,139
		8,816,405
	Biotechnology 1.1%	
1,505	Exact Sciences Corp., 1.00%, 1/15/25	1,601,405
7,260	Intercept Pharmaceuticals, Inc., 3.25%, 7/1/23	6,016,536
		7,617,941
	Building Materials 0.5%	
3,225	Cemex S.A.B de C.V., 3.72%, 3/15/20	3,211,174
	Commercial Services 1.1%	
7,960	Huron Consulting Group, Inc., 1.25%, 10/1/19	7,609,259
	Distribution/Wholesale 0.7%	
4,975	Titan Machinery, Inc., 3.75%, 5/1/19	4,937,548
	Diversified Financial Services 2.3%	
7,030	Encore Capital Group, Inc., 3.00%, 7/1/20	7,393,079
9,160	PRA Group, Inc., 3.00%, 8/1/20	8,936,963
		16,330,042
	Electric Utilities 1.0%	
6,905	NRG Yield, Inc., 3.25%, 6/1/20 (a)(b)	6,874,673
	Electrical Equipment 1.1%	
	SunPower Corp.,	
2,365	0.875%, 6/1/21	1,882,644
7,095	4.00%, 1/15/23	5,953,195
		7,835,839

Schedule of Investments

AllianzGI Convertible & Income Fund II

May 31, 2018 (unaudited) (continued)

Principal Amount (000s)		Value*
	Electronics 0.8%	
$5,955	OSI Systems, Inc., 1.25%, 9/1/22	$ 5,517,319
	Energy-Alternate Sources 2.4%	
5,160	Pattern Energy Group, Inc., 4.00%, 7/15/20	5,191,074
12,690	Tesla Energy Operations, Inc., 1.625%, 11/1/19	11,752,729
		16,943,803
	Equity Real Estate Investment Trusts (REITs) 1.3%	
3,025	Two Harbors Investment Corp., 6.25%, 1/15/22	3,126,338
5,810	Western Asset Mortgage Capital Corp., 6.75%, 10/1/22	5,895,122
		9,021,460
	Healthcare/Healthcare Distributors 0.9%	
8,615	Aceto Corp., 2.00%, 11/1/20	6,286,486
	Insurance 2.5%	
9,260	AmTrust Financial Services, Inc., 2.75%, 12/15/44	8,492,892
8,605	AXA S.A., 7.25%, 5/15/21 (a)(b)	9,319,215
		17,812,107
	Iron/Steel 0.1%	
690	AK Steel Corp., 5.00%, 11/15/19	806,745
	Oil, Gas & Consumable Fuels 1.5%	
2,150	Green Plains, Inc., 4.125%, 9/1/22	2,271,957
1,720	Nabors Industries, Inc., 0.75%, 1/15/24	1,363,470
7,525	Whiting Petroleum Corp., 1.25%, 4/1/20	7,151,120
		10,786,547
	Pharmaceuticals 1.7%	
9,210	Dermira, Inc., 3.00%, 5/15/22	7,320,081
2,460	Horizon Pharma Investment Ltd., 2.50%, 3/15/22	2,319,556
2,585	Jazz Investments I Ltd., 1.50%, 8/15/24 (a)(b)	2,651,698
		12,291,335

	Pipelines 2.1%	
18,700	Cheniere Energy, Inc., 4.25%, 3/15/45	14,956,241
	Retail 1.2%	
7,860	RH, zero coupon, 6/15/19 (a)(b)	8,211,562
	Semiconductors 0.4%	
2,970	Veeco Instruments, Inc., 2.70%, 1/15/23	2,670,386
	Software 1.9%	
11,915	Avid Technology, Inc., 2.00%, 6/15/20	10,425,625
3,015	Synchronoss Technologies, Inc., 0.75%, 8/15/19	2,831,884
		13,257,509
	Tobacco 1.5%	
	Vector Group Ltd. (g),	
4,335	3 mo. Cash Dividends on Common Stock + 1.75%, 1.75%, 4/15/20	4,574,795
4,685	3 mo. Cash Dividends on Common Stock + 2.50%, 2.50%, 1/15/19	6,323,766
		10,898,561
	Transportation 1.3%	
3,010	Aegean Marine Petroleum Network, Inc., 4.25%, 12/15/21	2,118,140
3,440	Echo Global Logistics, Inc., 2.50%, 5/1/20	3,537,473
3,555	Teekay Corp., 5.00%, 1/15/23 (a)(b)	3,433,696
		9,089,309
	Total Convertible Bonds & Notes (cost-$210,762,463)	216,857,722

Schedule of Investments

AllianzGI Convertible & Income Fund II

May 31, 2018 (unaudited) (continued)

Shares		Value*
CONVERTIBLE PREFERRED STOCK 26.4%		
	Banks 3.9%	
9,140	Bank of America Corp., 7.25%, Ser. L (e)	$ 11,571,240
12,835	Wells Fargo & Co., 7.50%, Ser. L (e)	16,133,595
		27,704,835
	Chemicals 0.9%	
51,505	Rayonier Advanced Materials, Inc., 8.00%, 8/15/19, Ser. A	6,524,911
	Commercial Services & Supplies 0.7%	
110,120	Stericycle, Inc., 5.25%, 9/15/18	5,256,028
	Diversified Financial Services 0.2%	
21,530	AMG Capital Trust II, 5.15%, 10/15/37	1,283,246
	Diversified Telecommunication Services 0.2%	
117,480	Frontier Communications Corp., 11.125%, 6/29/18, Ser. A	1,473,199
	Electric Utilities 2.0%	
228,650	Dominion Energy, Inc., 6.75%, 8/15/19, Ser. A	10,072,032
71,590	NextEra Energy, Inc., 6.123%, 9/1/19	4,051,994
		14,124,026
	Electronic Equipment, Instruments & Components 0.9%	
76,780	Belden, Inc., 6.75%, 7/15/19	6,033,372
	Equity Real Estate Investment Trusts (REITs) 5.3%	
7,795	Crown Castle International Corp., 6.875%, 8/1/20, Ser. A	8,142,111
476,235	RLJ Lodging Trust, 1.95%, Ser. A (e)	12,182,091
309,935	Sutherland Asset Management Corp., 7.00%, 8/15/23	7,969,978
149,485	Welltower, Inc., 6.50%, Ser. I (e)	8,664,151
		36,958,331
	Gas Utilities 1.5%	
184,475	South Jersey Industries, Inc., 7.25%, 4/15/21	10,183,020
	Hand/Machine Tools 1.6%	
104,940	Stanley Black & Decker, Inc., 5.375%, 5/15/20	11,184,579
	Healthcare-Products 2.1%	
249,440	Becton Dickinson and Co., 6.125%, 5/1/20, Ser. A	14,521,599

	Insurance 1.8%	
120,100	Assurant, Inc., 6.50%, 3/15/21, Ser. D	12,587,681
	Multi-Utilities 1.2%	
86,080	Sempra Energy, 6.00%, 1/15/21, Ser. A	8,538,275
	Oil, Gas & Consumable Fuels 2.8%	
120,125	Anadarko Petroleum Corp., 7.50%, 6/7/18	3,944,905
130,590	Kinder Morgan, Inc., 9.75%, 10/26/18, Ser. A	4,275,517
91,750	Nabors Industries Ltd., 6.00%, 5/1/21	4,715,950
173,845	Sanchez Energy Corp., 6.50%, Ser. B (e)	3,165,717
47,645	WPX Energy, Inc., 6.25%, 7/31/18, Ser. A	3,607,679
		19,709,768
	Pharmaceuticals 1.3%	
23,315	Teva Pharmaceutical Industries Ltd., 7.00%, 12/15/18	9,369,133
	Total Convertible Preferred Stock (cost-$198,821,118)	185,452,003
PREFERRED STOCK (a)(d)(f)(i)(j) **1.1%**		
	Media 1.1%	
3,554	LiveStyle, Inc., Ser. A	483,522
76,572	LiveStyle, Inc., Ser. B	7,657,200
5,000	LiveStyle, Inc., Ser. B	50
	Total Preferred Stock (cost-$12,855,447)	8,140,772
COMMON STOCK (a)(d)(f)(i) **0.3%**		
	Advertising 0.3%	
133,715	Affinion Group Holdings, Inc., Class A (h) (acquisition cost-$2,371,020; purchased 11/9/15-11/12/15)	1,700,855
	Aerospace & Defense 0.0%	
6,354	Erickson, Inc.	205,298
	Media 0.0%	
90,407	LiveStyle, Inc. (j)	9
	Total Common Stock (cost-$7,842,203)	1,906,162

Schedule of Investments

AllianzGI Convertible & Income Fund II

May 31, 2018 (unaudited) (continued)

Units		Value*
WARRANTS (d)(f)(i) **0.0%**		
	Commercial Services 0.0%	
1,562,241	Cenveo, Inc., strike price $12.00, expires 6/10/24 (b)	$ 2
	Media 0.0%	
19,500	LiveStyle, Inc., expires 11/30/21, Ser. C (a)(j)	2
	Total Warrants (cost-$183,305)	4

Principal Amount (000s)		
	Repurchase Agreements 3.9%	
$27,105	State Street Bank and Trust Co., dated 5/31/18, 0.28%, due 6/1/18, proceeds $27,105,211; collateralized by U.S. Treasury Notes, 2.00%, due 8/15/25, valued at $27,647,718 including accrued interest (cost-$27,105,000)	27,105,000
	Total Investments (cost-$738,627,299) (k) **100.0%**	**702,214,503**
	Liabilities in excess of other assets	(7,122,706)
	Preferred Shares	(274,000,000)
	Net Assets Applicable to Common Shareholders	**$ 421,091,797**

* Portfolio securities and other financial instruments for which market quotations are readily available are stated at market value. Market value is generally determined on the basis of official closing prices, last reported sales prices, or if no sales or closing prices are reported, on the basis of quotes obtained from a quotation reporting system, established market makers, or independent pricing services. The Fund s investments are valued daily using prices supplied by an independent pricing service or broker/dealer quotations, or by using the last sale or settlement price on the exchange that is the primary market for such securities, or the mean between the last bid and ask quotations. Independent pricing services use information provided by market makers or estimates of market values obtained from yield data relating to investments or securities with similar characteristics.

The Board of Trustees (the Board) has adopted procedures for valuing portfolio securities and other financial instruments in circumstances where market quotations are not readily available (including in cases where available market quotations are deemed to be unreliable), and has delegated primary responsibility for applying the valuation methods to the investment manager, Allianz Global Investors U.S. LLC (the Investment Manager). The Fund s Valuation Committee was established by the Board to oversee the implementation of the Fund s valuation methods and to make fair value determinations on behalf of the Board, as necessary. The Investment Manager monitors the continued appropriateness of methods applied and identifies circumstances and events that may require fair valuation. The Investment Manager determines if adjustments should be made in light of market changes, events affecting the issuer, or other factors. If the Investment Manager determines that a valuation method may no longer be appropriate, another valuation method previously approved by the Fund s Valuation Committee may be selected or the Fund s Valuation Committee will be convened to consider the matter and take any appropriate action in accordance with procedures adopted by the Board. The Board shall review and ratify the appropriateness of the valuation methods and these methods may be amended or supplemented from time to time by the Fund s Valuation Committee.

Short-term debt instruments maturing in 60 days or less are valued at amortized cost, if their original term to maturity was 60 days or less, or by amortizing premiums or discounts based on their value on the 61^{st} day prior to maturity, if the original term to maturity exceeded 60 days.

The prices used by the Fund to value investments may differ from the value that would be realized if the investments were sold, and these differences could be material. The Fund s net asset value (NAV) is normally determined at the close of regular trading (normally, 4:00 p.m. Eastern Time) on the New York Stock Exchange (NYSE) on each day the NYSE is open for business. In unusual circumstances, the Board or the Valuation Committee may in good faith determine the NAV as of 4:00 p.m., Eastern Time, notwithstanding an earlier, unscheduled close or halt of trading on the NYSE.

(a) Private Placement Restricted as to resale and may not have a readily available market. Securities with an aggregate value of $133,662,746, representing 19.0% of total investments.

(b) 144A Exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration, typically only to qualified institutional buyers. Securities with an aggregate value of $123,615,812, representing 17.6% of total investments.

(c) In default.

(d) Fair-Valued Securities with an aggregate value of $10,046,938 representing 1.4% of total investments.

(e) Perpetual maturity. The date shown, if any, is the next call date.

(f) Level 3 security.

(g) In addition to the coupon rate shown, the issuer is expected to pay additional interest based on the actual dividends paid on its common stock.

(h) Restricted. The aggregate acquisition cost of such securities is $14,467,923. The aggregate value is $2,029,497, representing 0.3% of total investments.

(i) Non-income producing.

(j) A member of the Fund s portfolio management team is a member of the board of directors of LiveStyle, Inc. The Fund s aggregate value of investments in LiveStyle, Inc. represents 1.2% of total investments.

(k) At May 31, 2018, the cost basis of portfolio securities for federal income tax purposes was $743,220,393. Gross unrealized appreciation was $34,588,616; gross unrealized depreciation was $75,594,506; and net unrealized depreciation was $41,005,890. The difference between book and tax cost was attributable to wash sale loss deferrals and the differing treatment of bond amortization.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (*i.e.,* the exit price) in an orderly transaction between market participants. The three levels of the fair value hierarchy are described below:

Level 1 quoted prices in active markets for identical investments that the Fund has the ability to access

Level 2 valuations based on other significant observable inputs, which may include, but are not limited to, quoted prices for similar assets or liabilities, interest rates, yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates or other market corroborated inputs

Level 3 valuations based on significant unobservable inputs (including the Investment Manager s or Fund s Valuation Committee s own assumptions and securities whose price was determined by using a single broker s quote)

The valuation techniques used by the Fund to measure fair value during the three months ended May 31, 2018 were intended to maximize the use of observable inputs and to minimize the use of unobservable inputs.

The Fund s policy is to recognize transfers between levels at the end of the reporting period. An investment asset s or liability s level within the fair value hierarchy is based on the lowest level input, individually or in aggregate, that is significant to the fair value measurement. The objective of fair value measurement remains the same even when there is a significant decrease in the volume and level of activity for an asset or liability and regardless of the valuation techniques used. Investments categorized as Level 1 or 2 as of period end may have been transferred between Levels 1 and 2 since the prior period due to changes in the valuation method utilized in valuing the investments.

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. The following are certain inputs and techniques that the Fund s generally uses to evaluate how to classify each major category of assets and liabilities within Level 2 and Level 3, in accordance with accounting principles generally accepted in the United States of America.

Equity Securities (Common and Preferred Stock and Warrants) Equity securities traded in inactive markets are valued using inputs which include broker-dealer quotes, recently executed transactions adjusted for changes in the benchmark index, or evaluated price quotes received from independent pricing services that take into account the integrity of the market sector and issuer, the individual characteristics of the security, and information received from broker-dealers and other market sources pertaining to the issuer or security. To the extent that these inputs are observable, the values of equity securities are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Convertible Bonds & Notes Convertible bonds & notes are valued by independent pricing services based on various inputs and techniques, which include broker-dealer quotations from relevant market makers and recently executed transactions in securities of the issuer or comparable issuers. The broker-dealer quotations received are supported by credit analysis of the issuer that takes into consideration credit quality assessments, daily trading activity, and the activity of the underlying equities, listed bonds and sector-specific trends. To the extent that these inputs are observable, the values of convertible bonds & notes are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

Corporate Bonds & Notes Corporate bonds & notes are generally comprised of two main categories: investment grade bonds and high yield bonds. Investment grade bonds are valued by independent pricing services using various inputs and techniques, which include broker-dealer quotations, live trading levels, recently executed transactions in securities of the issuer or comparable issuers, and option adjusted spread models that include base curve and spread curve inputs. Adjustments to individual bonds can be applied to recognize trading differences compared to other bonds issued by the same issuer. High yield bonds are valued by independent pricing services based primarily on broker-dealer quotations from relevant market makers and recently executed transactions in securities of the issuer or comparable issuers. The broker-dealer quotations received are supported by credit analysis of the issuer that takes into consideration credit quality assessments, daily trading activity, and the activity of the underlying equities, listed bonds and sector-specific trends. To the extent that these inputs are observable, the values of corporate bonds & notes are categorized as Level 2. To the extent that these inputs are unobservable, the values are categorized as Level 3.

A summary of the inputs used at May 31, 2018 in valuing the Fund s assets and liabilities is listed below (refer to the Schedule of Investments for more detailed information on Investments in Securities):

	Level 1 - Quoted Prices	Level 2 - Other Significant Observable Inputs	Level 3 - Significant Unobservable Inputs	Value at 5/31/18
Investments in Securities Assets				
Corporate Bonds & Notes:				
Media		$ 14,400,360	$ 72	$ 14,400,432
All Other		248,352,408		248,352,408
Convertible Bonds & Notes		216,857,722		216,857,722
Convertible Preferred Stock:				
Diversified Financial Services		1,283,246		1,283,246
Equity Real Estate Investment Trusts		8,142,111		8,142,111
Hand/Machine Tools		11,184,579		11,184,579
Healthcare-Products		14,521,599		14,521,599
Oil, Gas & Consumable Fuels	$ 16,544,051	3,165,717		19,709,768
Pharmaceuticals		9,369,133		9,369,133
All Other	121,241,567			140,568,257
Preferred Stock			8,140,772	8,140,772
Common Stock			1,906,162	1,906,162
Warrants			4	4
Repurchase Agreements		27,105,000		27,105,000
Totals	$ 137,785,618	$ 554,381,875	$ 10,047,010	$ 702,214,503

At May 31, 2018, securities valued at $19,326,690 were transferred from Level 1 to Level 2. This transfer was result of securities with an exchange-traded closing price at February 28, 2018, using an exchange mean price at May 31, 2018.

At May 31, 2018, security valued $6,524,911 was transferred from Level 2 to Level 1. This transfer was result of security with an exchange mean price at February 28, 2018, using an exchange-traded closing price at May 31, 2018.

	Beginning Balance 2/28/18	Purchases	Sales	Accrued Discount (Premiums)	Net Realized Gain (Loss)	Net Change in Unrealized Appreciation/ Depreciation	Transfers into Level 3*	Transfers out of Level 3	Ending Balance 5/31/18
Investments in Securities Assets									
Corporate Bonds & Notes:									
Media	$	$	$	$	$	$	$ 72	$	$ 72
Preferred Stock:									
Media	8,491,150		(650,957)		181,840	118,739			8,140,772
Common Stock:									
Advertising	2,024,445					(323,590)			1,700,855
Aerospace & Defense	199,452					5,846			205,298
Media	9								9
Warrants:									
Commercial Services	273					(271)			2
Media	2								2
Totals	$ 10,715,331	$	$ (650,957)	$	$ 181,840	$ (199,276)	$ 72	$	$ 10,047,010

* At May 31, 2018, a security valued at $72 was transferred from Level 2 to Level 3. The transfer was due to uncertainty regarding receipt of updated financial statements and data related to a current evaluated price.

Schedule of Investments

AllianzGI Convertible & Income Fund II

May 31, 2018 (unaudited) (continued)

The following table presents additional information about valuation techniques and inputs used for investments that are measured at fair value and categorized within Level 3 at May 31, 2018:

	Ending Balance at 5/31/18	Valuation Technique Used	Unobservable Inputs	Input Values (Range)
Investments In Securities - Assets				
Preferred Stock	$483,522	Market and Company Comparables	EV Multiples	0.69x (0.30x - 1.16x)
			Applicable Liquidity Multiple	1.60
			Illiquidity Discount	30%
	$7,567,200		EV Multiples	0.69x (0.30x - 1.16x)
			Illiquidity Discount	30%
Common Stock	$1,700,855	Market and Company Comparables	EV Multiples	4.00x (0.51x - 12.15x)
			Illiquidity Discount	30%
				0%
	$205,298	Market and Company Comparables	EV Multiples	0.73x (0.48x - 1.10x)
			M&A Transaction Multiples	0.87x(0.32x - 2.12x)
			Illiquidity Discount	40%

The net change in unrealized appreciation/depreciation of Level 3 investments held at May 31, 2018 was $(189,893).

Glossary:

PIK - Payment-in-Kind

REIT - Real Estate Investment Trust

Item 2. Controls and Procedures

(a) The registrant s President & Chief Executive Officer and Treasurer, Principal Financial & Accounting Officer have concluded that the registrant s disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940 Act (the 1940 Act) (17 CFR 270.30a-3(c))) are effective based on their evaluation of these controls and procedures as of a date within 90 days of the filing date of this document.

(b) There were no significant changes in the registrant s internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act (17 CFR 270.30a-3(d))) that occurred during the registrant s last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant s internal control over financial reporting.

Item 3. Exhibits

Certifications pursuant to Rule 30a-2(a) under the 1940 Act are filed and attached here to as Exhibit 99_CERT:

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Registrant: AllianzGI Convertible & Income Fund II

By /s/ Thomas J. Fuccillo
Thomas J. Fuccillo

President & Chief Executive Officer

Date: July 20, 2018

By /s/ Scott Whisten
Scott Whisten

Treasurer, Principal Financial & Accounting Officer

Date: July 20, 2018

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By /s/ Thomas J. Fuccillo
Thomas J. Fuccillo

President & Chief Executive Officer

Date: July 20, 2018

By /s/ Scott Whisten
Scott Whisten

Treasurer, Principal Financial & Accounting Officer

Date: July 20, 2018

0in .0001pt;">$

$

11,000

Restricted cash and investments

1,208

1,208

Accounts receivable, net

21,396

(1,006

)

(274

)

20,116

Prepaid expenses and other

1,038

(211

)

827

Assets of disposal group held for sale receivable, net

42

42

Total current assets

35,012

(1,545

)

(274

)

33,193

Restricted cash and investments	
	4,980
	4,980
Property and equipment, net (net of reclassification of $2,694 Note 1)	
	112,965
	(9,919
)	
	(343
)	
	102,703
Intangible assets bed licenses	
	2,464

(88

)

2,377

Intangible assets lease rights, net

8,193

8,193

Goodwill (reclassification of $2,694 Note 1)

3,600

(1,123

)

88

2,565

Escrow deposits for acquisitions

3,604

3,604

Lease deposits

1,686

(1

)

1,685

Deferred loan costs, net

4,826

(610

)

85

4,301

Other assets

74

(2

)

72

Total assets

$

177,404

$

(13,197

)

$

(534

)

$

163,673

LIABILITIES AND STOCKHOLDERS EQUITY

Current portion of notes payable and other debt	$	7,655	$	(193	)	$	$	7,462

Revolving credit facilities and lines of credit

8,095

8,095

Accounts payable

14,655

(988

)

331

13,998

Accrued expenses

10,952

(429

)

1,042

11,565

Liabilities of disposal group held for sale

192

192

Total current liabilities

41,549

(1,610

)

1,373

41,312

Senior debt, net of discounts	
	97,163
	(12,339
)	
	84,824
Convertible debt, net of discounts	
	14,824
	14,824
Other debt	
	1,150

1,150

Derivative liability

1,479

1,479

Other liabilities

2,119

2,119

Deferred tax liability

67

28

95

Total liabilities

158,351

(13,949

)

1,401

145,803

Common stock and additional paid-in capital

39,068

109

39,177

Accumulated deficit

(18,919

)

(2,062

)

(20,981

)

Total stockholders equity

20,149

(1,953

)

18,196

Noncontrolling interest in subsidiaries

(1,096

)

752

18

(326

)

Total equity

19,053

752

(1,935

)

17,870

Total liabilities and equity

$

177,404

$

(13,197

)

$

(534

)

$

163,673

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NOTE 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

The following table presents the Company s previously issued (the As Reported) and restated (the As Restated) consolidated statement of operations for the three months ended March 31, 2012 (*in thousands, except per share information*):

	Three Months Ended March 31, 2012			
	As Reported	Oklahoma Owners	Other Adjustments	As Restated
Revenues				
Patient care revenues	$ 49,808	$ (3,225)	$ (276)	$ 46,307
Management revenues	363		161	524
Total revenues	50,171	(3,225)	(115)	46,831
Expenses:				
Cost of services (Exclusive of facility rent, depreciation and amortization)	40,123	(2,933)	1,617	38,807
General and administrative	3,931		62	3,993
Facility rent expense	2,065			2,065
Depreciation and amortization	1,497	(108)	321	1,710
Total expenses	47,616	(3,041)	2,000	46,575
Income from Operations	2,555	(184)	(2,115)	256
Other Income (Expense):				
Interest expense, net	(2,954)	276		(2,678)
Acquisition costs, net of gains	(293)			(293)
Derivative gain	410			410
Other expense	(16)		2	(14)
Total other expense, net	(2,853)	276	2	(2,575)
Loss from Continuing Operations Before Income Taxes	(298)	92	(2,113)	(2,319)
Income tax benefit (expense)	(54)		69	15
Loss from Continuing Operations	(352)	92	(2,044)	(2,304)
Loss from discontinued operations, net of tax	(109)			(109)
Net Loss	(461)	92	(2,044)	(2,413)
Net Loss Attributable to Noncontrolling Interest	255	(92)	(18)	145
Net Loss Attributable to AdCare Health Systems, Inc.	$ (206)	$	$ (2,062)	$ (2,268)
Net Loss per Common Share - Basic:				
Continuing Operations	$ (0.01)		$ (0.17)	$ (0.18)
Discontinued Operations	$ (0.01)			$ (0.01)
	$ (0.02)		$ (0.17)	$ (0.19)
Net Loss per Common Share - Diluted				
Continuing Operations	$ (0.01)		$ (0.17)	$ (0.18)
Discontinued Operations	$ (0.01)			$ (0.01)
	$ (0.02)		$ (0.17)	$ (0.19)

Weighted Average Common Shares Outstanding:			
Basic	12,204	21	12,225
Diluted	12,204	21	12,225

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NOTE 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS *(continued)*

The following table presents the Company s previously issued (the As Reported) and restated (the As Restated) statement of cash flows for the three months ended March 31, 2012 (*in thousands*):

	Three Months Ended March 31, 2012			
	As Reported	Oklahoma Owners	Other Adjustments	As Restated
Cash flows from operating activities:				
Net loss	$ (461)	$ 92	$ (2,044)	$ (2,413)
Loss from discontinued operations, net of tax	109			109
Loss from continuing operations	(352)	92	(2,044)	(2,304)
Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities:				
Depreciation and amortization	1,497	(108)	321	1,710
Warrants issued for services				
Stock based compensation expense	165		25	190
Lease expense in excess of cash	157			157
Amortization of deferred financing costs	381	(52)	8	337
Amortization of debt discounts	213			213
Derivative gain	(410)			(410)
Deferred tax (benefit) expense	(19)		28	9
Gain on disposal of assets	(2)			(2)
Provision for bad debts	615	(26)	329	918
Other noncash items	16		(16)	
Changes in certain assets and liabilities, net of acquisitions:				
Accounts receivable	(3,151)	231	(131)	(3,051)
Prepaid expenses and other	(373)	175	(2)	(200)
Other assets	(22)	57	145	180
Accounts payable and accrued expenses	3,351	(601)	1,110	3,860
Net cash provided by operating activities continuing operations	2,066	(232)	(227)	1,607
Net cash used in operating activities discontinued operations	(204)		99	(105)
Net cash provided by operating activities	1,862	(232)	(128)	1,502
Cash flows from investing activities:				
Proceeds from sale of property and equipment	3			3
Change in restricted cash and investments and escrow deposits for acquisitions	637		(71)	566
Acquisitions	(3,130)		(4,789)	(7,919)
Purchase of property and equipment	(522)	38	21	(463)
Net cash used in investing activities continuing operations	(3,012)	38	(4,839)	(7,813)
Net cash used in investing activities discontinued operations				
Net cash used in investing activities	(3,012)	38	(4,839)	(7,813)
Cash flows from financing activities:				
Proceeds from debt	3,523		272	3,795
Proceeds from debt used in acquisitions			4,693	4,693

Debt issuance costs								(206)			(206)
Change in line of credit		(556)									(556)
Exercise of warrants and options		23									23
Proceeds from stock issuances, net		3,642						(1)			3,641
Repayment of notes payable		(1,470)			46			209			(1,215)
Net cash provided by financing activities continuing operations		5,162			46			4,967			10,175
Net cash used in financing activities discontinued operations		(48)									(48)
Net cash provided by financing activities		5,114			46			4,967			10,127
Net Change in cash		3,964			(148)						3,816
Cash, Beginning		7,364			(180)						7,184
Cash, Ending	$	11,328		$	(328)		$			$	11,000
Supplemental Disclosure of Cash Flow Information:											
Cash paid during the period for:											
Interest	$	2,238		$			$	316		$	2,554
Income taxes	$	13		$			$	(13)		$	
Supplemental Disclosure of Non-cash Activities:											
Acquisitions in exchange for debt and equity instruments	$	9,800		$			$	(4,800)		$	5,000
Warrants issued for financings costs	$	191		$			$	85		$	276
Noncash debt issuance costs	$	164		$			$	(164)		$	

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NOTE 3. LIQUIDITY AND PROFITABILITY

The Company had a net loss of approximately $2,413,000 for the three months ended March 31, 2012, and had negative working capital of approximately $8,119,000 at March 31, 2012. The Company s ability to achieve sustained profitable operations is dependent on continued growth in revenue and controlling costs.

Management s plans for increasing liquidity and profitability in future years encompass the following:

- refinancing debt where possible to obtain more favorable terms;
- increasing facility occupancy and improving the occupancy mix by increasing Medicare patients;
- acquiring additional long term care facilities with existing cash flowing operations to expand our operations; and
- adding additional management contracts.

Management believes that the foregoing actions, if taken by the Company, should provide the opportunity for the Company to improve liquidity and achieve profitability; however, there is no assurance that such actions will occur. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 4. DISCONTINUED OPERATIONS

As part of the Company s strategy to focus on the growth of its skilled nursing segment, the Company decided in the fourth quarter of 2011 to exit the home health segment of the business. This segment represented less than 2% of total revenues for the Company over the past year.

As a result of the decision to exit the home health business, the assets and liabilities that are expected to be sold are reflected as assets and liabilities held for sale and are comprised of the following:

(Amounts in 000 s)		**March 31, 2012**		**December 31, 2011**
Property and equipment, net	$	40	$	45
Other assets		2		2
Assets of disposal group held for sale	$	42	$	47
Current portion of debt	$	192	$	197
Notes payable				43

Liabilities of disposal group held for sale	$	192	$	240

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

NOTE 5. SEGMENTS

The Company reports its operations in three segments: Skilled Nursing Facility (SNF), Assisted Living Facility (ALF), and Corporate & Other. The SNF and ALF segments provide services to individuals needing long-term care in a nursing home or assisted living setting and management of those facilities. The Corporate & Other segment engages in the management of facilities and accounting and IT services. We evaluate financial performance and allocate resources primarily based upon segment operating income (loss). Segment operating results exclude interest expense and other non-operating income and expenses. The table below contains our segment information for the three months ended March 31, 2012 and 2011.

(Amounts in 000 s)	**SNF**	**ALF**	**Corporate & Other**	**Eliminations**	**Total**
Three months ended March 31, 2012 Restated (Note 2)					
Net revenue	$ 43,044	$ 3,263	$ 2,849	$ (2,325)	$ 46,831
Cost of services	38,763	2,369		(2,325)	38,807
General and administrative	36		3,957		3,993
Facility rent expense	2,065				2,065
Depreciation and amortization	1,330	210	170		1,710
Operating income/(loss)	$ 850	$ 684	$ (1,278)	$	$ 256
Total assets, March 31, 2012	$ 105,663	$ 27,389	$ 40,470	$ (9,849)	$ 163,673
Three months ended March 31, 2011					
Net revenue	$ 28,191	$ 2,341	$ 2,712	$ (2,214)	$ 31,030
Cost of services	25,324	1,985	80	(2,214)	25,175
General and administrative			2,924		2,924
Facility rent expense	1,903				1,903
Depreciation and amortization	459	152	36		647
Operating income/(loss)	$ 505	$ 204	$ (328)	$	$ 381
Total assets, December 31, 2011	$ 110,532	$ 22,328	$ 35,792	$ (9,548)	$ 159,104

NOTE 6. PROPERTY AND EQUIPMENT

(Amounts in 000 s)	**Estimated Useful Lives (Years)**	**March 31, 2012 Restated (Note 2)**	**December 31, 2011**

Buildings and improvements	5-40	$	94,514	$	93,371
Equipment	2-10		7,501		7,108
Land			7,346		7,636
Computer related	2-10		2,433		2,414
Construction in process			245		77
			112,039		110,606
Less: accumulated depreciation expense			8,761		7,624
Less: accumulated amortization expense			575		533
Property and equipment, net		$	102,703	$	102,449

For the quarters ended March 31, 2012 and 2011, depreciation and amortization expense was approximately $1,710,000 and $647,000, respectively.

In 2012, a reclassification adjustment was made to the December 31, 2011 balance sheet to recognize $2.7 million of goodwill acquired in acquisitions that was previously reported as bed licenses included in property and equipment. The Company does not amortize goodwill or indefinite lived intangibles.

During the quarter ended March 31, 2012, the Company recognized a $389,000 impairment charge to write down the carrying value of an office building located in Rogers, Arkansas. The office building was acquired in a 2011 acquisition. The purchase price allocation for that acquisition was deemed to be final as of December 31, 2011. Subsequent to December 31, 2011, it was determined that the acquired office building would not be utilized and the building was not in use as of March 31, 2012. The impairment charge represents a change in fair value from value recognized in the purchase price allocation. The impairment charge is classified as depreciation expense in the consolidated statement of operations and is included in the Company s Skilled Nursing Facility segment.

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NOTE 7. RESTRICTED CASH AND INVESTMENTS

The following table sets forth the Company s various restricted cash, escrow deposits and investments:

(Amounts in 000 s)		March 31, 2012		December 31, 2011
HUD escrow deposits	$	172	$	326
Funds held in trust for residents		24		45
Refundable escrow deposit				500
Collateral certificates of deposit		1,012		1,012
Total current portion		1,208		1,883
HUD reserve replacement		1,143		1,130
Reserves for capital improvements		1,836		1,767
Restricted investments for other debt obligations		2,001		1,973
Total noncurrent portion		4,980		4,870
Total restricted cash and investments	$	6,188	$	6,753

Refundable escrow deposit In March 2012, the Company terminated an agreement to acquire or lease 15 skilled nursing facilities and, as a result of such termination, the deposit was refunded.

NOTE 8. ACCRUED EXPENSES

Accrued expenses consist of the following:

(Amounts in 000 s)		March 31, 2012 Restated (Note 2)		December 31, 2011
Accrued payroll related	$	5,146	$	5,040
Accrued employee benefits		3,224		2,023
Real estate and other taxes		1,166		982
Other accrued expenses		2,029		1,836
Total accrued expenses	$	11,565	$	9,881

NOTE 9. NOTES PAYABLE AND OTHER DEBT

Notes payable and other debt consists of the following:

(Amounts in 000 s)		March 31, 2012 Restated (Note 2)		December 31, 2011
Revolving credit facilities and lines of credit	$	8,095	$	8,651
Senior debt - guaranteed by HUD		15,869		15,738
Senior debt - guaranteed by USDA		28,796		38,717
Senior debt - guaranteed by SBA		5,040		5,087
Senior debt - bonds, net of discount		6,179		6,176
Senior debt - other mortgage indebtedness		31,043		23,823
Other debt		6,508		4,197
Convertible debt issued in 2010, net of discount		10,316		10,105
Convertible debt issued in 2011		4,509		4,509
Total notes payable and other debt		116,355		117,003
Less current portion		15,557		11,910
Notes payable and other debt, net of current portion	$	100,798	$	105,093

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NOTE 9. NOTES PAYABLE AND OTHER DEBT *(continued)*

Scheduled Maturities

The following is a summary of the scheduled maturities of indebtedness as of March 31, 2012 for each of the next five years and thereafter:

		(Amounts in 000 s)
2013	$	15,557
2014		19,606
2015		1,898
2016		1,979
2017		2,140
Thereafter		76,695
Subtotal		117,875
Less: unamortized discounts		(1,520)
Total notes payable and other debt	$	116,355

Debt Covenant Compliance

As of March 31, 2012, the Company (including its consolidated variable interest entity) had 26 different credit facilities (credit facilities, mortgage notes, bonds and other credit obligations) outstanding that include various financial and administrative covenant requirements. Covenant requirements include, but are not limited to, fixed charge coverage ratios, debt service coverage ratios, minimum EBITDA or EBITDAR, current ratios and tangible net worth requirements. Certain financial covenant requirements are based on consolidated financial measurements whereas others are based on subsidiary level (i.e., facility, multiple facilities or a combination of subsidiaries comprising less than the Company's consolidated financial measurements). Some covenants are based on annual financial metric measurements whereas others are based on monthly or quarterly financial metric measurements. The Company routinely tracks and monitors its compliance with its covenant requirements, In recent periods, including as of March 31, 2012, the Company has not been in compliance with certain financial and administrative covenants. For each instance of such non-compliance, the Company has obtained waivers or amendments to such requirements, including, as necessary, modifications to future covenant requirements or the elimination of certain requirements in future periods.

Senior debt other mortgage indebtedness

Hearth and Home of Vandalia

In January 2012, the Company refinanced the Hearth and Home of Vandalia facility through the issuance of a term loan insured by U.S. Department of Housing and Urban Development (HUD) with a financial institution for a total amount of $3,721,500 that matures in 2041. The HUD term loan requires monthly principal and interest payments of approximately $17,500 with a fixed interest rate of 3.74%. Deferred financing costs incurred on the term loan amounted to approximately $201,000 and are being amortized to interest expense over the life of the

HUD term loan. The HUD term loan has a prepayment penalty of 8% through 2014 declining by 1% each year through 2022.

Woodland Manor

In connection with the January 2012 acquisition of the skilled nursing facility located in Springfield, Ohio, known as Woodland Manor, the Company entered into a loan agreement for $4,800,000. The loan matures in December 2016 with a required final payment of approximately $4,300,000 and accrues interest at the LIBOR rate plus 4% with a minimum rate of 6% per annum. The loan requires monthly principal payments of $8,500 plus interest for total current monthly payments of approximately $33,000. Deferred financing costs incurred on the loan amounted to approximately $107,300 and are being amortized to interest expense over the life of the loan. The loan has a prepayment penalty of 5% through 2012 declining by 1% each year through 2015. The loan is secured by the Woodland Manor facility and guaranteed by AdCare.

Eaglewood Village

In connection with the January 2012 acquisition of the assisted living facility located in Springfield, Ohio, known as Eaglewood Village, the Company entered into a loan agreement for $4,500,000. The loan matures in June 2012 and accrues interest at 6.5% per annum from January 1, 2012 through February 29, 2012, 8.5% per annum from March 1, 2012 through April 30, 2012 and 10.5% per annum after May 1, 2012. The loan may be prepaid at any time without penalty. The loan is secured by the Eaglewood Village facility and guaranteed by AdCare. The loan is due within one year but has been classified as long-term because the Company refinanced this short-term obligation on April 12, 2012 (see Note 15).

Other Debt

Eaglewood Village Promissory Note

In connection with the January 2012 acquisition of Eaglewood Village, Eaglewood Village, LLC and Eaglewood Property Holdings, LLC, each a wholly owned subsidiary of AdCare, issued a promissory note in the amount of $500,000. The note matures in January 2014 and bears interest at 6.5% per annum payable monthly beginning February 2012. The note requires monthly principal and interest payments of $3,700. The note may be prepaid without penalty at any time.

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NOTE 9. NOTES PAYABLE AND OTHER DEBT *(continued)*

Other Debt *(continued)*

Cantone Promissory Note

In March 2012, the Company issued a promissory note to Cantone Asset Management LLC in the amount of $3,500,000. The promissory note bears interest at 10% per annum and matures in October 2012. The interest rate increases 1% each month beginning in July 2012 through October 2012. The note may also be prepaid without penalty at any time. In connection with the issuance of the note, Cantone Research, Inc. has agreed to provide us with certain consulting services for a monthly fee if the Company and Cantone Asset Management LLC (or an affiliated entity) do not agree to the terms of an additional financing arrangement pursuant to which it (or affiliated entity) would loan to us at least $4,000,000 for a four-year term.

NOTE 10. ACQUISITIONS

Summary of 2012 Acquisitions

During the quarter ended March 31, 2012, the Company acquired one skilled nursing facility and one assisted living facility described further below and is pursuing a number of other acquisitions. The Company has incurred a total of approximately $293,000 of acquisition costs in the Other Income (Expense) section of the Consolidated Statements of Operations.

Woodland Manor and Eaglewood Village

On January 1, 2012, the Company acquired one skilled nursing facility and one assisted living facility both located in Springfield, Ohio. The total purchase price was $12,412,000 after final closing adjustments.

		(Amounts in 000 s)
Consideration Transferred:		
Net proceeds from loans	$	4,693
Seller notes		5,000
Cash from earnest money deposits		250
Cash (prepaid on December 30, 2011)		2,469
Total consideration transferred	$	12,412

Assets Acquired:		
Land	$	370
Building		9,656
Equipment and Furnishings		1,199
Intangible Assets bed licenses		1,188
Goodwill		87
Total assets acquired		12,500
Liabilities Assumed:		
Real estate taxes and other		(88)
Total identifiable net assets	$	12,412

Unaudited Pro forma Financial Information

Acquisitions have been included in the consolidated financial statements since the dates the Company gained control. Combined revenue for all 2012 acquisitions is approximately $2,474,000 and resulted in income from operations of approximately $401,000.

The following table represents pro forma results of consolidated operations as if all of the 2011 and 2012 acquisitions had occurred at the beginning of the earliest fiscal year being presented, after giving effect to certain adjustments.

	Three Months Ended March 31,			
(Amounts in 000 s)		**2012**		**2011**
Pro Forma Revenue	$	46,831	$	45,843
Pro Forma Operating Expenses	$	46,570	$	44,336
Pro Forma Income from Operations	$	260	$	1,507

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NOTE 10. ACQUISITIONS *(continued)*

Unaudited Pro forma Financial Information *(continued)*

The forgoing pro forma information is not indicative of what the results of operations would have been if the acquisitions had actually occurred at the beginning of the periods presented and is not intended as a projection of future results or trends.

NOTE 11. STOCKHOLDERS EQUITY

2012 Public Stock Offering

In March 2012, the Company closed a firm commitment underwritten public offering of 1,100,000 shares of common stock at an offering price to the public of $3.75 per share. The Company received net proceeds of approximately $3.6 million after deducting underwriting discounts, and other offering-related expenses of approximately $0.5 million. The Company has also granted the underwriter in the offering an option for 45 days to purchase up to an additional 165,000 shares of common stock to cover over-allotments, if any. This overallotment option expired on May 11, 2012.

NOTE 12. STOCK BASED COMPENSATION

Employee Common Stock Warrants & Options

In February 2012, the Company granted non-qualified stock options to Christopher Brogdon, the Company s Vice Chairman and Chief Acquisition Officer, pursuant to the Company s 2011 Stock Incentive Plan (the 2011 Plan). A total of 50,000 options were granted with an exercise price per share of $7.00 and 100,000 options were granted with an exercise price of $8.00. The options vest in September of 2013 and 2014, respectively. The options are exercisable until the term expires in February, 2022. The fair value of the options was estimated at $1.19 and $1.03 per share, respectively, and is being recognized as share-based compensation expense over the requisite service period of the awards.

In March 2012, the Company granted incentive stock options to certain members of management pursuant to the 2011 Plan. A total of 429,200 options were granted with an exercise price per share of $4.13. The options vest ratably on the day before each of the three subsequent anniversaries. The options are exercisable until the term expires in March, 2017. The fair value of the options was estimated at $1.34 per share and is being recognized as share-based compensation expense over the requisite service period of the awards.

Nonemployee Common Stock Warrants

On March 29, 2012, in connection with the issuance of the $3,500,000 promissory note to Cantone Asset Management LLC, the Company granted to Cantone Asset Management LLC a warrant to purchase 300,000 shares of common stock at an exercise price per share of $4.00. The warrant is exercisable until the term expires in March, 2015. The fair value of the warrant was estimated at $0.64 per share and is included in deferred loan costs and will be amortized as interest expense over the life of the promissory note. During the restatement process (Note 2), the fair value of the warrants was reviewed, and the Company determined that the warrants should be revalued using an estimated life correlating to the legal term of the warrant. The revised fair value was estimated to be $0.92; the additional expense is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note.

NOTE 13. VARIABLE INTEREST ENTITIES

As further described in Note 19 to the consolidated financial statements in the Annual Report, the Company has certain variable interest entities that are required to be consolidated. In connection with the restatement process (Note 2), the Company has determined that certain entities which the Company had previously recognized as variable interest entities and consolidated their results with the results of the Company during the first three quarters of 2012 as well as the third and fourth quarter of 2011, should not have been consolidated. These entities are the five skilled nursing facilities located in Oklahoma which are managed by the Company (known as the Oklahoma Owners). As a result of the restatements described in Note 2, the Company s consolidated financial statements for the first quarter of 2012 do not include the results of the Oklahoma Owners. The Company concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements. The following summarizes the assets and liabilities of the variable interest entities included in the consolidated balance sheets at March 31, 2012 and December 31, 2011:

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NOTE 13. VARIABLE INTEREST ENTITIES *(continued)*

Riverchase Village Facility - Assets and Liabilities:

(Amounts in 000 s)	March 31, 2012	December 31, 2011
Cash	$ 4	$ 16
Accounts receivable	21	10
Restricted investments	470	451
Property and equipment, net	5,959	5,999
Other assets	452	432
Total assets	$ 6,906	$ 6,908
Accounts payable	$ 826	$ 740
Accrued expenses	227	173
Notes payable	6,179	6,176
Noncontrolling interest	(326)	(181)
Total liabilities	$ 6,906	$ 6,908

The balances related to the Oklahoma Owners variable interest entities that were consolidated as of December 31, 2011 but that the Company subsequently determined should not be consolidated were as follows:

(Amounts in 000 s)	December 31, 2011
Cash	$ 180
Accounts receivable	800
Property and equipment, net	9,988
Goodwill	1,123
Other assets	641
Total assets	$ 12,732
Accounts Payable	$ 458
Accrued expenses	356
Notes payable	12,578
Noncontrolling interest	(660)
Total liabilities	$ 12,732

NOTE 14. FAIR VALUE MEASUREMENTS

The following are the major categories of assets and liabilities measured at fair value on a recurring basis during the three months ended March 31, 2012, using quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3).

(Amounts in 000 s)	Level 1:	Level 2:	Level 3:	Total at March 31, 2012
Derivative Liability	$	$	$ 1,479	$ 1,479

Following is a reconciliation of the beginning and ending balances for the derivative liability measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the period ended March 31, 2012:

(Amounts in 000 s)	Derivative Liability
Beginning Balance	$ 1,889
Additions	
Total gain	(410)
Ending Balance	$ 1,479

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NOTE 15. COMMITMENTS AND CONTINGENCIES

Legal Matters

The skilled nursing business involves a significant risk of liability given the age and health of the Company s patients and residents and the services the Company provides. The Company and others in the industry are subject to an increasing number of claims and lawsuits, including professional liability claims, which may allege that services have resulted in personal injury, elder abuse, wrongful death or other related claims. The defense of these lawsuits may result in significant legal costs, regardless of the outcome, and can result in large settlement amounts or damage awards.

In addition to the potential lawsuits and claims described above, the Company is also subject to potential lawsuits under the Federal False Claims Act and comparable state laws alleging submission of fraudulent claims for services to any healthcare program (such as Medicare) or payor. A violation may provide the basis for exclusion from federally-funded healthcare programs. As of March 31, 2012, the Company does not have any material loss contingencies recorded or requiring disclosure based on management s evaluation of the probability of loss from known claims.

Commitments

Arkansas - Little Rock, Northridge and Woodland Hills

On December 29, 2011, the Company entered into a Purchase and Sale Agreement to purchase three skilled nursing facilities located in Little Rock, Arkansas for a total purchase price of` $27,280,000. Subsequent to December 31, 2011, the Company was required to deposit $1,100,000 into escrow to be held as earnest money. If the agreement is terminated due to the sellers failure to satisfy certain conditions set forth therein, then the deposit shall be returned to the Company. If the Company does not consummate the purchase, the sellers will retain the deposit. The Company extended the closing to March 31, 2012, with the payment of an additional $500,000 in earnest money, and also deposited $1,200,000 into escrow to be held as an earnest deposit.

Arkansas - Abington

On January 3, 2012, the Company entered into a Purchase and Sale Agreement with SCLR, LLC to acquire certain land, buildings, improvements, furniture, fixtures, operating agreements and equipment comprising Abington Place Health and Rehab Center, a 120-bed skilled nursing facility located in Little Rock, Arkansas, for an aggregate purchase price of $3,600,000. Pursuant to the agreement, the Company deposited $150,000 into escrow to be held as earnest money. Upon consummation of the purchase, the deposit will be retained by the Abington Place Seller and applied against the purchase price. The closing of the Abington Place purchase is expected to occur on April 1, 2012. The Company may extend the closing until April 30, 2012, subject to payment of an additional $100,000 in earnest money.

Westlake / Quail Creek

On March 12, 2012, we entered into a Purchase and Sale Agreement with Westlake Nursing Home Limited to acquire a 118-bed skilled nursing facility located in Oklahoma City, Oklahoma, for an aggregate purchase price of $5,800,000. Pursuant to the Purchase and Sale Agreement, we deposited $25,000 into escrow to be held as earnest money. We expect the closing of the acquisition to occur on May 15, 2012.

Tulsa Companion Care

On March 14, 2012, we entered into a Purchase and Sale Agreement with F & F Ventures, LLC and Tulsa Christian Care, Inc., doing business as Companions Specialized Care Center to acquire a 121-bed skilled nursing facility located in Tulsa, Oklahoma for an aggregate purchase price of $5,750,000. The purchase price consists of a $5,000,000 cash payment and the issuance of shares of our common stock with an aggregate value of $750,000, with such shares valued at the average closing price of our common stock for the ten-day period ending on the last business day prior to the closing of the acquisition. Pursuant to the Purchase and Sale Agreement, we deposited $150,000 into escrow to be held as earnest money. We expect the closing of the acquisition to occur on or before June 30, 2012. In addition, the Company and Tulsa Christian Care, Inc. entered into an interim management agreement for this skilled nursing facility effective April 1, 2012.

NOTE 16. SUBSEQUENT EVENTS

Strome Promissory Note

On April 1, 2012, the Company issued a promissory note to Strome Alpha Offshore Ltd., in the amount of $5,000,000. The promissory note bears interest at 10% per annum and matures in November 2012. The note may also be prepaid without penalty at any time. In connection with the issuance of the promissory note, the Company granted to Strome Alpha Offshore Ltd. a warrant to purchase 312,500 shares of common stock at an exercise price per share of $4.00. The warrant is exercisable until April, 2015. The fair value of the warrant was estimated at $0.61 per share and will be included in financing costs and expensed over the life of the promissory note issued in connection with the financing. During the restatement process, the fair value of the warrants was reviewed, and the Company determined that the warrants should be revalued using a life equal to the term of the warrant. The revised fair value was estimated to be $0.88; the additional expense is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note.

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NOTE 16. SUBSEQUENT EVENTS *(continued)*

Arkansas Acquisition

On April 1, 2012, we completed the acquisition of: (i) Little Rock Health & Rehab, a 154-bed skilled nursing facility located in Little Rock, Arkansas; (ii) Northridge Healthcare and Rehabilitation, a 140-bed skilled nursing facility located in North Little Rock, Arkansas; and (iii) Woodland Hills Healthcare and Rehabilitation, a 140-bed skilled nursing facility located in Little Rock, Arkansas from Little Rock Aviv, L.L.C., Woodland Arkansas, L.L.C. and Northridge Arkansas, L.L.C., pursuant to the previously announced Purchase and Sale Agreement, between the sellers and AdCare Property Holdings, LLC, dated as of December 29, 2011, for an aggregate purchase price of $27,280,000. In connection with the closing of this acquisition, Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC, and Woodland Hills HC Property Holdings, LLC, each our wholly owned subsidiary, entered into a Loan Agreement with The PrivateBank and Trust Company in an aggregate principal amount of $21,800,000.

The loan matures on March 30, 2017. Interest on the loan accrues on the principal balance thereof at an annual rate of the greater of (i) 6.0% per annum or (ii) the LIBOR rate plus 4.0% per annum, and payments for the interest and a portion of the principal balance are payable monthly, commencing on May 1, 2012. The entire outstanding principal balance of the loan, together with all accrued but unpaid interest thereon, is payable on March 30, 2017. The loan is secured by a first mortgage on the real property and improvements constituting the facilities and guaranteed by AdCare.

Glennville PSA

On April 3, 2012, the Company entered into an agreement to acquire a 160-bed skilled nursing facility located in Glennville, Georgia for an aggregate purchase price of $8,240,000.

Springfield Bond Financing

On April 12, 2012, the Company entered into a bond loan agreement with the City of Springfield in the State of Ohio (Springfield), pursuant to which Springfield lent to the Company the proceeds from the sale of its Series 2012 Bonds, which consists of the (i) $6,610,000 The City of Springfield, Ohio, First Mortgage Revenue Bonds (Eaglewood Property Holdings, LLC Project), Series 2012A (the Series 2012A Bonds); and (ii) $620,000 The City of Springfield, Ohio, First Mortgage Revenue Bonds (Eaglewood Property Holdings, LLC Project), Taxable Series 2012B (the Series 2012B Bonds ; collectively, the Series 2012 Bonds). The Series 2012A Bonds mature on May 1, 2042 and bear interest at 7.65% annually. The Series 2012B Bonds mature on May 1, 2021 and bear interest at 8.50% annually. The Company utilized the proceeds from the issuance of the Series 2012 Bonds to repay the $4.5 million loan entered into to complete the acquisition of Eaglewood Village; make certain repairs and improvements to the Eaglewood Village facility; fund certain reserves; and pay the cost of the issuance of the Series 2012 Bonds.

Oklahoma PSA Amendment

On April 17, 2012, the Company amended its agreement with First Commercial Bank, to acquire six skilled nursing facilities located in Oklahoma. The amendment requires an additional deposit of $50,000 into escrow to be used as earnest money; amends the closing date to the date which is sixty (60) days after all required licenses are received, but in no event later than September 30, 2012; and releases $200,000 from escrow to First Commercial Bank. Upon the closing of the purchase, the Company shall receive a $200,000 credit against the purchase price; however if the transaction fails to be consummated for any reason other than (i) default by First Commercial Bank; (ii) the failure of a condition to closing to be satisfied; or (iii) an event of casualty or condemnation, First Commercial Bank shall be entitled to retain the $200,000 disbursed from escrow. If the transaction fails to be consummated for any reason other than as described in the preceding sentence, First Commercial Bank shall return the $200,000 to the Company upon demand.

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NOTE 16. SUBSEQUENT EVENTS *(continued)*

Cantone Promissory Note   April 2012

On April 27, 2012, we issued a promissory note in favor of Cantone Asset Management LLC for an aggregate principal amount of $1,500,000. The note matures on the earlier of: (i) October 1, 2012; or (ii) the date on which we receive proceeds, in an amount not less than $6,000,000, from a public offering or private placement of our common stock or debt securities. Interest on the note accrues on the principal balance thereof at an annual rate of 10%; provided, however, if the entire principal amount of the note is not paid by July 1, 2012, the interest rate shall increase by 1% for each month or part thereof during which any principal amount of the note shall remain unpaid. We may prepay the note in whole or in part, at any time, without notice or penalty; provided, however, if the note is prepaid prior to October 1, 2012, then we shall continue to pay interest on the note through such date. Payments of all amounts under the note are subordinate and junior in right of priority to the prior payment in full of a promissory note we issued to Cantone Asset Management LLC, dated March 30, 2012, in the principal amount of $3,500,000.

Sumter Valley PSA

On April 27, 2012, we entered into a Purchase and Sale Agreement with Pinewood Holdings, LLC to acquire the Sumter Valley Nursing and Rehab Center, a 96-bed skilled nursing facility located in Sumter, South Carolina, for an aggregate purchase price of $5,500,000. The purchase price consists of: (i) $5,250,000 cash consideration; and (ii) a $250,000 promissory note to be issued by AdCare to Pinewood Holdings LLC that shall bear interest at a fixed rate of 6% based on a 15 year amortization schedule. Pursuant to the Purchase and Sale Agreement, we deposited $100,000 into escrow to be held as earnest money. We expect the closing of the acquisition to occur on July 31, 2012.

Abington Acquisition

On April 30, 2012, we completed the acquisition of Abington Place Health and Rehab Center, a 120-bed skilled nursing facility located in Little Rock, Arkansas from SCLR, LLC, pursuant to that certain previously announced Purchase and Sale Agreement, between SCLR, LLC and AdCare Property Holdings, LLC, dated as of January 3, 2012, for an aggregate purchase price of $3,600,000. In connection with the closing of this acquisition, APH&R Property Holdings, LLC, our wholly owned subsidiary, entered into a Loan Agreement with Metro City Bank in an aggregate principal amount of $3,425,500. We will take effective control over operations on June 1, 2012.

The loan matures on September 1, 2012. Interest on the loan accrues on the principal balance thereof at an annual rate of 2.25% per annum plus the prime interest rate, to be adjusted on a monthly basis (but in no event shall the total interest be less than 6.25% per annum), and payments for the interest are payable monthly, commencing on June 1, 2012 and ending on September 1, 2012. The entire outstanding principal balance of the loan, together with all accrued but unpaid interest thereon, is payable on September 1, 2012. The loan is secured by a first mortgage on the real property and improvements constituting the facility. We assigned to Metro City Bank a certificate of deposit in the amount of $1,000,000 as additional security for the loan.

Convacare

On January 17, 2012, we entered into a Purchase and Sale Agreement with Gyman Properties, LLC to acquire a 141-bed skilled nursing facility located in Lonoke, Arkansas, for an aggregate purchase price of $6,486,000. Pursuant to the Purchase and Sale Agreement, we deposited $250,000 into escrow to be held as earnest money. On May 9, 2012, the Company assigned all of its rights under the Purchase and Sale Agreement to GL Nursing, LLC, an entity affiliated with Christopher Brogdon, the Company s Vice Chairman and Chief Acquisition Officer.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Special Note Regarding Forward Looking Statements

Certain statements in this Quarterly Report on Form 10-Q/A (this Quarterly Report) constitute forward-looking statements. These forward-looking statements involve known or unknown risks, uncertainties and other factors that may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. This information includes assumptions made by, and information currently available to management, including statements regarding future economic performance and financial condition, liquidity and capital resources, and management s plans and objectives. You can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, estimates, predicts, potential, continues, or the negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments or otherwise, except as required by applicable laws. You should read this Management s Discussion and Analysis of Financial Condition and Results of Operations in conjunction with the consolidated financial statements and related notes included in this Quarterly Report and in the Annual Report on Form 10-K, as well as other reports that we file with the SEC.

Change in Accounting for Variable Interest Entities

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company s audited consolidated financial statements and notes included in the Company s Annual Report, effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company), acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810-10, *Consolidation - Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company s first quarter 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

Overview

The Company owns and manages skilled nursing facilities and assisted living facilities. We deliver skilled nursing, assisted living and home health services through wholly owned separate operating subsidiaries. During the first quarter of 2012, we acquired two facilities (one skilled nursing facility and one assisted living facility), bringing our Company s total bed count to 4,794 at March 31, 2012. The following tables provide summary information regarding our recent acquisitions and facility composition.

	March 31, 2012	December 31, 2011	December 31, 2010
Cumulative number of facilities	52	44(*)	27
Cumulative number of operational beds	4,794	3,916(*)	2,484

(*) Including the five Oklahoma Facilities which are not consolidated in 2012 as discussed in Note 2. The Oklahoma Facilities included 314 operational beds.

	Number of Operational	Number of Facilities at March 31, 2012				
State	Beds/Units	Owned	VIE	Leased	Managed for Third Parties	Total
Arkansas	964	9				9
Alabama	408	2	1			3
Georgia	1,497	3		10		13
Missouri	80			1		1
North Carolina	106	1				1
Ohio	981	10		1	4	15
Oklahoma	758				10	10
Total	4,794	25	1	12	14	52
Facility Type						
Skilled Nursing	4,299	17		12	13	42
Assisted Living	412	8	1			9
Independent Living	83				1	1
Total	4,794	25	1	12	14	52

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Acquisitions

We have embarked on a strategy to grow our business through acquisitions and leases of senior care facilities and businesses providing services to those facilities. During the first quarter 2012, we acquired two facilities (one skilled nursing facility and one assisted living facility), bringing our Company s total bed count to 3,602 at March 31, 2012.

- On December 30, 2011, we acquired a skilled nursing facility and an assisted living facility both located in Springfield, Ohio, for an aggregate adjusted purchase price of $12,412,000.

Subsequent to March 31, 2012, the following acquisitions were completed:

- On April 1, 2012, we acquired three skilled nursing facilities located in Little Rock, Arkansas. The total purchase price was $27,280,000.

- On April 30, 2012, we acquired a skilled nursing facility located in Little Rock, Arkansas for an aggregate purchase price of $3,600,000. We will obtain effective control and plan to commence operations on June 1, 2012.

In addition, the following potential acquisitions have been announced during the three months ended March 31, 2012:

- On January 17, 2012, we entered into a Purchase and Sale Agreement with Gyman Properties, LLC to acquire a 141-bed skilled nursing facility located in Lonoke, Arkansas, for an aggregate purchase price of $6,486,000. Pursuant to the Purchase and Sale Agreement, we deposited $250,000 into escrow to be held as earnest money. On May 9, 2012, the Company assigned all of its rights under the Purchase and Sale Agreement to GL Nursing, LLC, an entity affiliated with Christopher Brogdon, the Company s Vice Chairman and Chief Acquisition Officer.

- On March 12, 2012, we entered into a Purchase and Sale Agreement with Westlake Nursing Home Limited to acquire a 118-bed skilled nursing facility located in Oklahoma City, Oklahoma, for an aggregate purchase price of $5,800,000. Pursuant to the Purchase and Sale Agreement, we deposited $25,000 into escrow to be held as earnest money.

- On March 14, 2012, we entered into a Purchase and Sale Agreement with F & F Ventures, LLC and Tulsa Christian Care, Inc., doing business as Companions Specialized Care Center to acquire a 121-bed skilled nursing facility located in Tulsa, Oklahoma for an aggregate purchase price of $5,750,000. The purchase price consists of a $5,000,000 cash payment and the issuance of shares of our common stock with an aggregate value of $750,000, with such shares valued at the average closing price of our common stock for the ten-day period ending on the last business day prior to the closing of the acquisition. Beginning April 1, 2012, we entered into a management agreement to operate the facility in the interim period.

For information regarding purchase and sale agreements of facilities that have been entered into subsequent to March 31, 2012, see Note 16 in the   Notes to Consolidated Financial Statements   section of Part I, Item 1 of this Quarterly Report.

We are currently evaluating potential acquisition opportunities in addition to those described above and we continue to seek new opportunities to further our growth strategy. No assurance is made that any of these potential acquisition opportunities will be determined to be appropriate for us or that we will complete any of such acquisitions on terms acceptable to us, or at all.

Segments

The Company reports its operations in three segments: Skilled Nursing Facilities (SNF), Assisted Living Facilities (ALF), and Corporate & Other. The Company delivers services through wholly owned separate operating subsidiaries. The SNF and ALF segments provide services to individuals needing long-term care in a nursing home or assisted living setting and management of those facilities. The Corporate & Other segment engages in the management of facilities and accounting and IT services. We evaluate financial performance and allocate resources primarily based on segment operating income (loss). Segment operating results exclude interest expense and other non-operating income and expenses. See Note 5 in the   Notes to Consolidated Financial Statements   section of Part I, Item 1 of this Quarterly Report.

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Skilled Nursing Facilities

We focus on two primary indicators in evaluating the financial performance in this segment. Those indicators are facility occupancy and patient mix. Facility occupancy is important as higher occupancy generally leads to higher revenues. In addition, concentrating on increasing the number of Medicare covered admissions (the patient mix) helps in increasing revenues. We include commercial insurance covered admissions that are reimbursed at the same level as those covered by Medicare in our Medicare utilization percentages and analysis.

For the three months ended March 31, 2012, revenue in our skilled nursing segment increased by approximately $14,853,000 compared to March 31, 2011, as a result of acquisitions during the year. This segment had income from operations of $850,000 as a result of improved quality mix as well as expense control. We expect to continue to implement and refine strategies designed to sustain these goals. Total assets increased by $4,869,000 due to acquisitions made since March 31, 2011.

Same Facilities results represent those owned and leased facilities we began to operate prior to January 1, 2011.

Recently Acquired Facilities results represents those owned and leased facilities we began to operate subsequent to January 1, 2011.

Average Occupancy

	Three Months Ended March 31, 2012	2011
Same Facilities	85.9%	86.8%
Recently Acquired Facilities	76.3%	n/a
Total	82.4%	86.8%

We continue our work towards maximizing the number of patients covered by Medicare where our operating margins are higher.

Patient Mix

Three Months Ended March 31,

	Same Facilities		Recently Acquired Facilities		Total	
	2012	2011	2012	2011	2012	2011
Medicare	15.2%	15.5%	14.3%	n/a	14.9%	15.5%
Medicaid	73.2%	76.4%	71.5%	n/a	72.6%	76.4%

Other	11.6%	8.1%	14.2%	n/a	12.5%	8.1%
Total	100.0%	100.0%	100.0%	n/a	100.0%	100.0%

For the Three Months Ended March 31, 2012:

State (SNF Only)	Operational Beds at Period End(1)	Period s Average Operational Beds	Occupancy (Operational Beds)	Medicare Utilization (Skilled %ADC)(2)	2012 Q1 Total Revenues	Medicare (Skilled) $PPD(3)	Medicaid $PPD(3)
Alabama	304	304	83.7%	12.8%	$ 4,881	$ 372.31	$ 182.77
Arkansas	932	498	70.9%	12.8%	$ 6,411	$ 352.68	$ 171.31
Georgia	1,497	1,497	86.6%	14.7%	$ 23,690	$ 456.78	$ 145.68
Missouri	80	80	61.3%	24.1%	$ 918	$ 394.89	$ 134.01
North Carolina	106	106	89.0%	18.1%	$ 1,904	$ 464.29	$ 154.91
Ohio	293	293	82.9%	17.7%	$ 5,240	$ 456.46	$ 158.76
Total	**3,212**	**2,778**	**82.4%**	**14.9%**	**$ 43,044**	**$ 433.06**	**$ 155.22**

(1) *Excludes managed beds which are not consolidated.*

(2) *ADC is the Average Daily Census*

(3) *PPD is the Per Patient Day equivalent*

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Assisted Living Facilities

For the three months ended March 31, 2012, revenue in our ALF segment increased by approximately $922,000 compared to March 31, 2011 as a result of increased revenue from acquisitions, an annual increase in rates charged to privately paying residents and increasing occupancy. This segment had income from operations of $684,000. Total assets increased by approximately $5,061,000 primarily due to acquisitions since March 31, 2011 and other building improvements made during the last 12 months.

	Average Occupancy Three Months Ended March 31, 2012	2011
Total	81.4%	74.5%

Residents of our assisted living facilities rely on their personal investments and wealth to pay for their stay. Although many of the risks still remain, such as declines in market values of investments, depressed market for the sale of private homes, and adult children caring for their elderly at home, we have seen an increase in census.

Corporate & Other

We manage eight skilled nursing facilities and one independent living campus for third party owners under management agreements that either are for a fixed monthly fee or for a percentage of revenue generated by the managed facility. Depending on the type of management agreement, our revenues increase annually according to inflationary adjustments stipulated in our management agreements or they increase as the facility s revenue increases for the management agreements that are based on a percentage of revenue. This segment includes our corporate overhead expenses, which are made up of salaries of our senior management team members and various other corporate expenses, including, but not limited to, corporate office operating expenses, audit fees, legal fees and board activities. Additionally, non-cash charges for compensation expense related to warrants, restricted stock and stock options are included in corporate overhead. We do not allocate these expenses to the divisions or separate them from management and development business for management review purposes.

Results of Operations

	Total Patient Care Revenues Three Months Ended March 31,			
Skilled Nursing (Amounts in 000 s)		**2012**		**2011**
Same Facilities	$	28,833	$	28,191
Recently Acquired Facilities		14,211		n/a
Total	$	43,044	$	28,191

	Three Months Ended March 31,			
Assisted Living (Amounts in 000 s)		**2012**		**2011**
Same Facilities	$	2,596	$	2,341

Recently Acquired Facilities		667		n/a
Total	$	3,263	$	2,341

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Comparison for the three months ended March 31, 2012 and 2011

Patient Care Revenues - For the periods presented, total patient care revenues increased by $15.8 million, or 51%.

Revenue in our SNF segment increased approximately $14,853,000 when compared to the three months ended March 31, 2011, primarily as a result of additional facilities acquired since March, 2011. In addition, quality mix improved at existing facilities. This segment had income from operations of $850,000 which is $345,000 higher compared to the three months ended March 31, 2011 as a result of higher revenue due to acquisitions and improved reimbursement rates. We are seeking to increase facility occupancy and to increase the number of patients covered by Medicare. We seek to continue to implement and refine strategies designed to achieve these goals.

Revenue in our ALF segment increased by approximately $922,000 when compared to the three months ended March 31, 2011, as a result of increased census and levels of care as well as the addition of one new facility in 2012 and one new facility in the fourth quarter of 2011. This segment had income from operations of $684,000 which is $480,000 more than the same period in 2011 from increased occupancy and an annual increase in rates charged to residents of the facilities.

Management Revenue - For the periods presented, management revenues (net of eliminations) increased $26,000, or 5%.

Cost of Services - For the periods presented, cost of services was approximately $38,807,000 compared to $25,175,000 for the same period a year ago. This is the result of numerous acquisitions over the past 12 months.

General and Administrative - For the periods presented, general and administrative costs have increased by $1,069,000 due to additional management staff necessary to direct the growth and maximize the results of the newly acquired facilities.

Three Months Ended March 31, 2012

(Amounts in 000 s)		Same Facilities		Recently Acquired Facilities		Total
SNF Other Operating Expenses	$	28,530	$	13,664	$	42,194
ALF Other Operating Expenses		2,065		514		2,579
Management/Corporate Other Operating Expenses		4,127				4,127
Eliminations		(1,580)		(745)		(2,325)
Total Other Operating Expenses	$	33,142	$	13,433	$	46,575

Infrastructure Costs - Company management separately identifies certain costs, which the Company has incurred that we believe are directly related to the growth of the Company. These infrastructure costs include, but are not limited to, additional management and staff necessary to support our operational teams in our newly acquired facilities, including those in states that we have not previously operated in. These costs are included in the consolidated statement of operations (included elsewhere in this Quarterly Report) under General and Administrative Expenses. Infrastructure costs were approximately $159,000 and $117,000 for the three months ended March 31, 2012 and 2011, respectively.

Facility Rent Expense - For the periods presented, lease expenses increased by $162,000 due to annual increases in rental rates and the addition of the one new leased facility in the fourth quarter of 2011.

	Three Months Ended March 31	
(Amounts in 000 s)	**2012**	**2011**
Lease Expense	$ 2,065	$ 1,903

Depreciation and Amortization - For the periods presented, depreciation and amortization increased by $1,063,000. The depreciation increase is directly related to acquisition activity that was not included in the 2011 results as it occurred in later periods and a $389,000 impairment charge recognized by the Company on an office building located in Rogers, Arkansas.

Interest Expense, net - For the periods presented, interest expense, net increased by $1,242,000, or 86%. We have entered into numerous debt instruments in relation to our growth strategy for the acquisition of the facilities which began in the third quarter of 2010. In addition, several of the arrangements are short term in nature resulting in higher interest rates than previously experienced and an increase in the amortization of deferred loan costs associated with the new debt agreements.

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Acquisition Costs, net of Gains - For the period ended March 31, 2012, acquisition costs, net of gains was an expense of $293,000, compared to a net gain of $979,000 for the comparative period. For the period ended March 31, 2012, the total acquisition costs were legal fees directly related to the acquisition of the two Ohio facilities and other costs incurred on potential future acquisitions. For the period ended March 31, 2011, the amount was the result of gains recognized on the acquisition of the Sylva, North Carolina facility during the first quarter of 2011.

Derivative Gain/Loss - For the period ended March 31, 2012, the derivative gain was $410,000, compared to a loss of $1,350,000 for the same period in 2011. The derivative is a product of a convertible debt instrument entered into during the third quarter of 2010. The expense associated with the derivative increases as the stock price climbs, and conversely decreases as the stock price declines. The price of the common stock of the Company declined during the three-month period ended March 31, 2012.

Other Income/(Expense) - For the periods presented, other income decreased by $620,000. There was a recovery of receivables recorded in the prior year which did not occur in the three months ended March 31, 2012.

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Critical Accounting Policies and Use of Estimates

Except for the re-assessment of our application of FASB ASC Topic 810, *Consolidation - Overall*, related to the Oklahoma Owners, there have been no significant changes during the three months ended March 31, 2012 to the items that we disclosed as our critical accounting policies and use of estimates in our discussion and analysis of financial condition and results of operation contained in the Annual Report.

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company s audited consolidated financial statements and notes included in the Company s Annual Report, effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company), acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to FASB ASC Topic 810, *Consolidation - Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company s first quarter 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

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Liquidity and Capital Resources

Overview

Liquidity is the measure of the Company s ability to have adequate cash or access to cash at all times in order to meet financial obligations when due, as well as to fund corporate expansion and other activities. Historically, the Company has met its liquidity requirements through a combination of net cash flow from operations, debt from third party lenders and issuances of other debt and equity securities.

We have negative working capital of approximately $8,119,000 at March 31, 2012. Our ability to sustain profitable operations is dependent on continued growth in revenue and controlling costs.

During the next twelve months, the Company believes it will require additional financing to satisfy its financial obligations and implement its expansion strategy. The Company is currently exploring several financing alternatives and may seek to raise additional capital through the sale of additional debt or equity securities, although there is no assurance that the Company will be able to raise additional capital through the issuance of debt or equity securities on terms acceptable to it, or at all. If the Company is unable to secure such additional financing, then the Company may be required to restructure its outstanding indebtedness and delay or modify its expansion plans.

Eaglewood Facilities Financing

On January 1, 2012, Woodland Holdings, LLC, our wholly owned subsidiary, entered into a loan agreement with The PrivateBank and Trust Company in an aggregate principal amount of $4,800,000. The loan was used to fund the acquisition of the Woodland Manor facility located in Springfield, Ohio.

The loan matures on December 30, 2016. Interest on the loan accrues on the principal balance thereof at an annual rate of the greater of (i) 6.0% per annum or (ii) the LIBOR rate plus 4.0% per annum, and payments for the interest and a portion of the principal balance are payable monthly, commencing on February 1, 2012 and ending on December 1, 2016. The entire outstanding principal balance of the loan, together with all accrued but unpaid interest thereon, is payable on December 30, 2016. The loan is secured by a first mortgage on the real property and improvements constituting the Woodland Manor facility and guaranteed by AdCare.

In addition, on January 1, 2012, Eaglewood Holdings, LLC and Eaglewood Village, LLC, our wholly owned subsidiaries, jointly and severally issued two promissory notes to Eaglewood Villa, Ltd. in the amount of $4,500,000 and $500,000. Proceeds from the notes were used to fund the acquisition of the Eaglewood Village facility located in Springfield, Ohio.

The $500,000 note matures on December 30, 2016 and the $4,500,000 note matures on June 30, 2012. Interest on the $500,000 note accrues at a rate of 6.5% per annum and interest on the $4,500,000 Eaglewood Loan accrues at a rate of (i) 6.5% per annum from January 1, 2012 to February 29, 2012; (ii) 8.5% per annum from March 1, 2012 to April 30, 2012; and (iii) 10.5% per annum from May 1, 2012 to June 30, 2012. Principal and interest payments under the notes shall be due and payable monthly, beginning on February 1, 2012. The notes are secured by a mortgage on the real property and improvements constituting the Eaglewood Village facility.

HUD Financing

On January 31, 2012, we refinanced the mortgage on our Home & Hearth of Vandalia facility to obtain a term note guaranteed by HUD. The HUD mortgage note requires monthly principal and interest payments with an annual fixed interest rate of 3.74%. The note matures in 2041. The note has a prepayment penalty of 8% for any prepayment made prior to March 1, 2014, which penalty is reduced by 1% each year thereafter until the eighth anniversary of such date, after which there is no prepayment penalty.

Cantone Promissory Note March 2012

On March 29, 2012, we issued a promissory note in favor of Cantone Asset Management LLC for an aggregate principal amount of $3,500,000. The note matures on the earlier of: (i) October 1, 2012; or (ii) the date on which we shall receive proceeds, in an amount not less than $6,000,000, from a public offering or private placement of our common stock. Interest on the note accrues on the principal balance thereof at an annual rate of 10%; provided, however, if the entire principal amount of the note is not paid by July 1, 2012, the interest rate shall increase by 1% for each month or part thereof during which any principal amount of the note shall remain

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unpaid. We may prepay the note in whole or in part, at any time, without notice or penalty; provided, however, if the note is prepaid prior to October 1, 2012, then we shall continue to pay interest on the note through such date.

In connection with the issuance of the note, Cantone Research, Inc. has agreed to provide us with certain consulting services for a monthly fee if the Company and Cantone Asset Management LLC (or an affiliated entity) do not agree to the terms of an additional financing arrangement pursuant to which it (or affiliated entity) would loan to us at least $4,000,000 for a four-year term.

2012 Public Stock Offering

In March 2012, we completed a firm commitment underwritten public offering of 1,100,000 shares of our common stock at a public offering price of $3.75 per share. We received net proceeds of approximately $3.6 million after deducting underwriting discounts, and other offering-related expenses of approximately $0.5 million. We intend to use the net proceeds from this offering for working capital and other general corporate purposes.

The Company has also granted the underwriters in the offering an option for 45 days to purchase an additional 165,000 shares of common stock to cover over-allotments, if any. This over-allotment option expires on May 11, 2012.

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For information on financings that have been entered into subsequent to March 31, 2012, see Note 16 in the Notes to Consolidated Financial Statements section of Part I, Item 1 of this Quarterly Report.

The following table presents selected data from our consolidated statement of cash flows for the periods presented (*in thousands*):

	Three Months Ended March 31 2012 As Restated (Note 2)	2011
Net cash provided by operating activities - continuing operations	$ 1,607	$ 623
Net cash (used in) provided by operating activities - discontinued operations	(105)	160
Net cash used in investing activities - continuing operations	(7,813)	(5,490)
Net cash provided by financing activities - continuing operations	10,175	10,546
Net cash used in financing activities - discontinued operations	(48)	(46)
Net change in cash and cash equivalents	3,816	5,793
Cash and cash equivalents at beginning of period	7,364	3,911
Cash decrease due to deconsolidation of variable interest entities	(180)	
Cash and cash equivalents at end of period	$ 11,000	$ 9,704

Three months ended March 31, 2012

Net cash provided by operating activities for the three months ended March 31, 2012, was approximately $1,502,000 consisting primarily of our net loss and changes in working capital, offset by noncash charges (primarily depreciation and amortization, share-based compensation, difference between straight-line rent and rent paid, and amortization of debt discounts and related deferred financing costs); all primarily the result of routine operating activity.

Net cash used in investing activities for the three months ended March 31, 2012, was approximately $7,813,000. This is primarily the result of funding our acquisitions, including making escrow deposits and purchase of property and equipment.

Net cash provided by financing activities was approximately $10,127,000 for the three months ended March 31, 2012. This is primarily the result of cash proceeds received from warrant exercises, the public stock offering, and proceeds from debt financings to fund our acquisitions, partially offset by repayments of existing debt obligations.

Three months ended March 31, 2011

Net cash used in operating activities for the three months ended March 31, 2011 was approximately $783,000 consisting primarily of our net loss from operations and changes in working capital partially offset by noncash charges, all primarily the result of routine operating activity.

Net cash used in investing activities for the three months ended March 31, 2011 was approximately $5,490,000. This is primarily the result of deposits for acquisitions and the purchase of additional equipment offset partially by reductions in restricted cash and investments.

Net cash provided by financing activities was approximately $10,500,000 for the three months ended March 31, 2011. This is primarily the result of proceeds from the convertible debt issuance net of issuance costs on March 31, 2011, and increases in borrowings on the line of credit partially offset by repayments of existing debt obligations.

Debt Covenant Compliance

As of March 31, 2012, the Company (including its consolidated variable interest entity) had 26 different credit facilities (credit facilities, mortgage notes, bonds and other credit obligations) outstanding that include various financial and administrative covenant requirements. Covenant requirements include, but are not limited to, fixed charge coverage ratios, debt service coverage ratios, minimum EBITDA or EBITDAR, current ratios and tangible net worth requirements. Certain financial covenant requirements are based on consolidated financial measurements whereas others are based on subsidiary level (i.e., facility, multiple facilities or a combination of subsidiaries comprising less than the Company s consolidated financial measurements). Some covenants are based on annual financial metric measurements whereas others are based on monthly or quarterly financial metric measurements. The Company routinely tracks and monitors its compliance with its covenant requirements. In recent periods, including as of March 31, 2012, the Company has not been in compliance with certain financial and administrative covenants. For each instance of such non-compliance, the Company has obtained waivers or amendments to such requirements, including, as necessary, modifications to future covenant requirements or the elimination of certain requirements in future periods.

The following table includes financial covenant requirements as of the last measurement date as of or prior to March 31, 2012 where the Company was not in compliance with the financial covenant or it achieved compliance with the covenant requirement by a margin of 10% or less. The table also identifies the related credit facility, outstanding balance at March 31, 2012 and the next applicable future financial covenant requirement inclusive of adjustments to covenant requirements resulting from amendments executed subsequent to March 31, 2012.

Period Ended							March 31, 2012	
Credit Facility	**Balance at March 31, 2012 (000 s)**	**Consolidated or Subsidiary Level Covenant Requirement**	**Financial Covenant**	**Measurement Period**	**Min/Max Financial Covenant Required**		**As Reported Financial Covenant Metric Achieved**	**As Restated Financial Covenant Metric Achieved**
Gemino - Line of Credit	$ 6,717	Consolidated	Fixed Charge Coverage Ratio (FCCR)	Quarterly	1.10		0.53	3.49*
PrivateBank - Line of Credit (Bentonville LOC)	$ 1,308	Subsidiary	FCCR	Quarterly	1.05		2.16	0.89*
PrivateBank - Mortgage Note - Homestead, Valley River, Bentonville	$ 11,678	Subsidiary	EBITDAR(000 s)	Quarterly	$ 450		$ 702	$ -4*
		Consolidated	DSCR	Annual	n/a		n/a	n/a
Square 1 USDA - Term Note - Homestead	$ 3,578	Subsidiary	Current ratio	Quarterly	1.00		0.37	0.27*
		Subsidiary	Maximum debt to net worth	Quarterly	9.00		7.57	14.34*
		Subsidiary	Tangible net worth	Quarterly	10.0%		11.7%	6.5%*
PrivateBank - Mortgage Note - Woodland Manor	$ 4,783	Subsidiary	Minimum quarterly EBITDAR (000 s)	Quarterly	$ 250		$ 301	$ 280
		Subsidiary	Minimum trailing twelve month FCCR	Quarterly	1.10		1.83	1.92

* Waiver or amendment for violation of covenant obtained.

Item 4. Controls and Procedures

As previously disclosed, the Audit Committee, in consultation with management, concluded in March 2013 that: (i) the Company s previously issued financial statements for the quarters ended March 31, 2012, June 30, 2012 and September 30, 2012 (the Relevant Financial Statements) should no longer be relied upon due to errors in the Relevant Financial Statements identified in connection with the audit of the Company s consolidated financial statements for the year ended December 31, 2012; and (ii) the Company would restate the Relevant Financial Statements.

The Audit Committee initiated a further review of, and inquiry with respect to, the accounting and financial issues related to these and other potential errors and engaged counsel to assist the Audit Committee with such matters. The Audit Committee completed its

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inquiry and, in connection therewith, assisted in the correction of certain errors relating to accounting and financial matters and identified certain material weaknesses in the Company s internal control over financial reporting, including weakness in the Company s ability to appropriately account for complex or non-routine transactions and in the quality and sufficiency of the Company s finance and accounting resources.

On July 8, 2013, the Company restated the Relevant Financial Statements by filing with the SEC amendments to its Quarterly Reports on Form 10-Q for the quarters ended March 31, 2012, June 30, 2012 and September 30, 2012.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed pursuant to the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report (the Evaluation Date). Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures were not effective.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes policies and procedures that are intended to:

(1) maintain records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and

(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. A control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system s objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefit of controls must be considered relative to their costs.

Management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this evaluation, management used the framework and criteria set forth in the report entitled *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The COSO framework summarizes each of the components of a company s internal control system, including: (i) the control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication and (v) monitoring.

Consistent with the results of the Audit Committee s review and inquiry, management identified material weaknesses in the Company s ability to appropriately account for complex or non-routine transactions and the quality and sufficiency of the Company s finance and accounting resources in relation to the increasing complexity and growth of the Company s operations.

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As a result of the material weaknesses described above, management has concluded that our internal control over financial reporting was not effective at December 31, 2012 based on the guidelines established in Internal Control Integrated Framework issued by COSO.

Changes in Internal Control over Financial Reporting and Remediation

In response to the material weaknesses in the Company s internal control over financial reporting, and based in part on recommendations made by the Audit Committee to the Board of Directors following the completion of the Audit Committee s review and inquiry, we have implemented, or plan to implement, the changes to our internal control over financial reporting discussed below.

- We hired Ronald W. Fleming to serve as Chief Financial Officer of the Company effective May 15, 2013. Mr. Fleming has relevant industry experience as well as experience with generally accepted accounting principles and SEC reporting and compliance.

- We have empowered Mr. Fleming to hire additional accounting and finance staff to ensure adequate internal control over financial reporting and operations.

- We are seeking to hire a permanent Chief Accounting Officer, as further discussed below.

- We have expanded the scope of our annual internal audit plan to include quarterly internal audit procedures with emphasis on the review of journal entries and non-recurring transactions.

In April 2013, we engaged an Interim Chief Accounting Officer on a contract basis. We are currently discussing with our Interim Chief Accounting regarding the terms of her employment as the Company s Chief Accounting Officer and believe that we will reach agreement on such terms in the near term.

Since January 2013, the Company has hired eight new finance and accounting personnel, including a Vice President of Facility Accounting Operations. Our new finance and accounting leadership continue to evaluate the qualifications and sufficiency of our accounting and finance department. The expanded internal audit scope has commenced and will be completed prior to the Company filing its Quarterly Reports on Form 10-Q for each of the 2013 quarterly periods.

Due to the short time period since we commenced our efforts to remediate our material weaknesses, and because we have not fully completed our financial reporting process for the quarter ended March 31, 2013, we have not yet been able to fully evaluate the effectiveness of such efforts. We have incurred, and will continue to incur, additional incremental costs associated with our remediation efforts, primarily due to hiring new finance and accounting personnel and external consultants and the implementation and validation of improved accounting and financial reporting procedures. If we are not successful in remediating our material weaknesses, or if we determine in future fiscal periods that we have additional material weaknesses in our internal control over financial reporting, then the reliability of our financial reports may be adversely impacted, we may be unable to file our reports with the SEC in a timely fashion and we could be required to restate our financial results. This could cause our investors to lose confidence in our financial reporting, which could adversely affect the trading price of our stock.

Other than the remediation efforts discussed above, which occurred in 2013 and have included the involvement of our new finance and accounting leadership in the preparation, review, and approval of the consolidated financial statements included in this Quarterly Report, there have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) since January 1, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

In addition, there were not any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the first quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 6. Exhibits

The agreements included as exhibits to this Quarterly Report are included to provide information regarding the terms of these agreements and are not intended to provide any other factual or disclosure information about the Company, its business or the other parties to these agreements. These agreements may contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:

- should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;

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- have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;

- may apply standards of materiality in a way that is different from what may be viewed as material to investors; and

- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time, and should not be relied upon by investors.

Exhibit No.	Description	Method of Filing
2.1	Purchase and Sale Agreement, dated as of January 3, 2012, between SCLR, LLC and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.9 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2011
2.2	Purchase and Sale Agreement, dated as of January 17, 2012, between Gyman Properties, LLC and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.1 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2011
2.3	Purchase and Sale Agreement, dated March 12, 2012, by and between Westlake Nursing Home Limited and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.1 to the Registrant s Current Report on Form 8-K filed March 15, 2012
2.4	Purchase and Sale Agreement, dated March 14, 2012, by and between F & F Ventures, LLC, Tulsa Christian Care, Inc., d/b/a/ Companions Specialized Care Center and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.2 to the Registrant s Current Report on Form 8-K filed March 15, 2012
2.5	Purchase and Sale Agreement, dated as of April 3, 2012, between Evans Memorial Hospital, Inc. and AdCare Property Holdings, LLC.	Incorporated by reference from Exhibit 2.1 to the Registrant s Current Report on Form 8-K filed April 9, 2012
2.6	Third Amendment to Purchase and Sale Agreement, dated as of April 17, 2012, by and between First Commercial Bank and AdCare Property Holdings, LLC.	Incorporated by reference from Exhibit 2.2 to the Registrant s Current Report on Form 8-K filed April 23, 2012
2.7	Purchase Agreement, dated as of April 27, 2012, between AdCare Property Holdings, LLC and Pinewood Holdings, LLC	Incorporated by reference from Exhibit 2.1 to the Registrant s Current Report on Form 8-K filed May 3, 2012
2.8	Second Amendment to Purchase and Sale Agreement, dated April 30, 2012, by and between Gyman Properties, LLC and AdCare Property Holdings, LLC	Incorporated by reference from Exhibit 2.2 to the Registrant s Current Report on Form 8-K filed May 3, 2012
3.1	Amended and Restated Articles of Incorporation	

Incorporated by reference from Exhibit 3.1 of the Registrant s Registration Statement Form SB (Registration No. 333-131542)

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Exhibit No.	Description	Method of Filing
		filed February 3, 2006
3.2	Code of Regulations	Incorporated by reference from Exhibit 3.2 of the Registrant s Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006
3.3	Amendment to Amended and Restated Articles of Incorporation	Incorporated by reference to Exhibit 3.3 of the Company s Quarterly Report on Form 10-Q for the quarter ended September 30, 2011
4.1	Warrant to Purchase 312,500 Shares of Common Stock, dated April 1, 2012, issued by AdCare Health Systems, Inc. to Strome Alpha Offshore Ltd.	Previously filed
4.2	Warrant to Purchase 300,000 Shares of Common Stock, dated March 30, 2012, issued by AdCare Health Systems, Inc. to Cantone Asset Management LLC	Previously filed
10.1	Mortgage Deed, recorded January 31, 2012, executed by Hearth and Home of Vandalia, Inc. in favor of Red Mortgage Capital, LLC	Previously filed
10.2	Mortgage Note, dated January 1, 2012, entered into by Hearth & Home of Vandalia, Inc. in favor of Red Mortgage Capital, LLC	Previously filed
10.3	Security Agreement, dated January 1, 2012, by and between Hearth and Home of Vandalia, Inc. and Red Mortgage Capital, LLC	Previously filed
10.4	Lessee Security Agreement, dated January 1, 2012, by and among AdCare Health Systems, Inc., Hearth & Home of Vandalia, Inc. and Red Mortgage Capital, LLC	Previously filed
10.5	Modification Agreement, dated as of March 9, 2012, by and among Benton Nursing, LLC, Park Heritage Nursing, LLC, Valley River Nursing, LLC, Homestead Nursing, LLC, Woodland Manor Nursing, LLC, Mountain View Nursing, LLC, AdCare Health Systems, Inc. and the PrivateBank and Trust Company	Incorporated by reference from Exhibit 99.2 to the Registrant s Current Report on Form 8-K filed March 15, 2012
10.6	Loan Agreement, dated as of March 30, 2012, by and among Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC, Woodland Hills HC Property Holdings, LLC and The PrivateBank and Trust Company	Previously filed
10.7	Promissory Note, dated as of March 30, 2012, issued by Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC and Woodland Hills HC Property Holdings, LLC in favor of The PrivateBank and Trust Company in the amount of $21,800,000	Previously filed

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Exhibit No.	Description	Method of Filing
10.8	Promissory Note, dated April 1, 2012, issued by AdCare Health Systems, Inc. in favor of Strome Alpha Offshore Ltd., in the amount of $5,000,000	Previously filed
10.9	Promissory Note, dated March 30, 2012, issued by AdCare Health Systems, Inc. in favor of Cantone Asset Management LLC, in the amount of $3,500,000	Previously filed
10.10	Note Purchase Agreement, dated March 29, 2012, by and between AdCare Health Systems, Inc. and Cantone Asset Management LLC	Previously filed
10.11	Guaranty of Payment and Performance, dated as of March 30, 2012, made by AdCare Health Systems, Inc., Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC and Woodland Hills HC Property Holdings, LLC, to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.12	Mortgage, Security Agreement, Assignment of Rents and Leases & Fixture Filing, dated as of April 1, 2012, executed by Little Rock HC&R Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.13	Mortgage, Security Agreement, Assignment of Rents and Leases & Fixture Filing, dated as of April 1, 2012, executed by Northridge HC&R Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.14	Mortgage, Security Agreement, Assignment of Rents and Leases & Fixture Filing, dated as of April 1, 2012, executed by Woodland Hills HC Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.15	Absolute Assignment of Rents and Leases, dated as of April 1, 2012, executed by Little Rock HC&R Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.16	Absolute Assignment of Rents and Leases, dated as of April 1, 2012, executed by Northridge HC&R Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.17	Absolute Assignment of Rents and Leases, dated as of April 1, 2012, executed by Woodland Hills HC Property Holdings, LLC to and for the benefit of The PrivateBank and Trust Company	Previously filed
10.18	Loan Agreement, dated as of April 12, 2012, between the City of Springfield, Ohio and Eaglewood Property Holdings, LLC	Previously filed
10.19	Guaranty Agreement, dated as of April 12, 2012, made and entered into by AdCare Health Systems, Inc., to and for the benefit of BOKF, NA dba Bank of Oklahoma	Previously filed

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Exhibit No.	Description	Method of Filing
10.20	Land Use Restriction Agreement, dated as of April 12, 2012, by and between BOKF, NA dba Bank of Oklahoma and Eaglewood Property Holdings, LLC	Previously filed
10.21	Open-End Mortgage, Assignment of Leases and Security Agreement, dated April 12, 2012, from Eaglewood Property Holdings, LLC to BOKF, NA dba Bank of Oklahoma	Previously filed
10.22	Loan Agreement, dated April 30, 2012, by and between APH&R Property Holdings, LLC and Metro City Bank	Incorporated by reference from Exhibit 99.1 to the Registrant s Current Report on Form 8-K filed May 3, 2012
10.23	Promissory Note, dated April 30, 2012, issued by APH&R Property Holdings, LLC in favor of Metro City Bank in the amount of $3,425,500	Incorporated by reference from Exhibit 99.2 to the Registrant s Current Report on Form 8-K filed May 3, 2012
10.24	Mortgage and Security Agreement, dated April 30, 2012, between APH&R Property Holdings, LLC and Metro City Bank	Incorporated by reference from Exhibit 99.3 to the Registrant s Current Report on Form 8-K filed May 3, 2012
10.25	Security Agreement, dated April 30, 2012, between APH&R Property Holdings, LLC and Metro City Bank	Incorporated by reference from Exhibit 99.4 to the Registrant s Current Report on Form 8-K filed May 3, 2012
10.26	Guaranty, dated as of April 30, 2012, between APH&R Property Holdings, LLC in favor of Metro City Bank	Incorporated by reference from Exhibit 99.5 to the Registrant s Current Report on Form 8-K filed May 3, 2012
10.27	Guaranty, dated as of April 30, 2012, between AdCare Health Systems, Inc. in favor of Metro City Bank	Incorporated by reference from Exhibit 99.6 to the Registrant s Current Report on Form 8-K filed May 3, 2012
10.28	Collateral Assignment of Certificate of Deposit, dated April 30, 2012, by and between APH&R Property Holdings, LLC and Metro City Bank	Incorporated by reference from Exhibit 99.7 to the Registrant s Current Report on Form 8-K filed May 3, 2012
10.29	Promissory Note, dated April 27, 2012, issued by Cantone Asset Management LLC in favor of AdCare Health Systems, Inc. in the amount of $1,500,000	Incorporated by reference from Exhibit 99.8 to the Registrant s Current Report on Form 8-K filed May 3, 2012
10.30	Assignment of Purchase and Sale Agreement, dated May 9, 2012, between AdCare Property Holdings, LLC and GL Nursing, LLC	Previously filed
31.1	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act.	Filed herewith
31.2	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act	Filed herewith
32.1	Certification of CEO pursuant to Section 906 of the Sarbanes-	Filed herewith

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Exhibit No.	Description	Method of Filing
	Oxley Act	
32.2	Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act	Filed herewith
101	The following financial information from AdCare Health Systems, Inc. Quarterly Report on Form 10-Q for the quarter ended March, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the three ended March 31, 2012 and 2011, (ii) Consolidated Balance Sheets as of March 31, 2012 and December 31, 2011, (iii) Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011, (iv) Consolidated Statements of Stockholders Equity for the three months ended March 31, 2012 and (i) the Notes to Consolidated Financial Statements.	Filed herewith

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SIGNATURES

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

ADCARE HEALTH SYSTEMS, INC.
(Registrant)

Date: October 22, 2013	/s/ Boyd P. Gentry Boyd P. Gentry Chief Executive Officer (Principal Executive Officer)
Date: October 22, 2013	/s/ Ronald W. Fleming Ronald W. Fleming Chief Financial Officer (Principal Financial and Accounting Officer)