

DENALI CAPITAL LLC
FORM ADV PART 2A

COVER PAGE

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NOTE: THIS BROCHURE PROVIDES INFORMATION ABOUT THE QUALIFICATIONS AND BUSINESS PRACTICES OF DENALI CAPITAL LLC. IF YOU HAVE ANY QUESTIONS ABOUT THE CONTENTS OF THIS BROCHURE, PLEASE CONTACT US AT 630-928-2570 OR DDEKKER@DENALICAP.COM. THE INFORMATION IN THIS BROCHURE HAS NOT BEEN APPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION OR BY ANY STATE SECURITIES AUTHORITY.

DENALI CAPITAL LLC IS A REGISTERED INVESTMENT ADVISER. REGISTRATION DOES NOT IMPLY A CERTAIN LEVEL OF SKILL OR TRAINING.

ADDITIONAL INFORMATION ABOUT DENALI CAPITAL LLC ALSO IS AVAILABLE ON THE SEC'S WEBSITE AT WWW.ADVISERINFO.SEC.GOV.

MATERIAL CHANGES

There have been no material changes in the business of Denali since the filing of its last brochure in March 2010. The format and certain required contents have changed since that time, per changes in SEC requirements that are effective with this filing.

TABLE OF CONTENTS

COVER PAGE	PAGE 1
MATERIAL CHANGES	PAGE 1
TABLE OF CONTENTS	PAGE 2
ADVISORY BUSINESS	PAGE 3
FEES AND COMPENSATION	PAGE 3
PERFROMANCE-BASED FEES AND SIDE BY SIDE MANAGEMENT	PAGE 4
TYPES OF CLIENTS	PAGE 5
METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS	PAGE 5
DISCIPLINARY INFORMATION	PAGE 7
OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS	PAGE 7
CODE OF ETHICS, PARTICIPATION, OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING	PAGE 7
BROKERAGE PRACTICES	PAGE 8
REVIEW OF ACCOUNTS	PAGE 9
CLIENT REFERRALS AND OTHER COMPENSATION	PAGE 9
CUSTODY	PAGE 10
INVESTMENT DISCRETION	PAGE 10
VOTING CLIENT SECURITIES	PAGE 10
FINANCIAL INFORMATION	PAGE 11

ADVISORY BUSINESS

Denali Capital LLC (“Denali”) is an investment management firm specializing in the sourcing, investment, and management of non-investment grade bank loans. Denali is the managing member of DC Funding Partners LLC (“DC Funding”). DC Funding has no employees. Denali provides essentially all advisory services to the funds managed by DC Funding. Denali and DC Funding have been in business since March of 2001.

Unless stated otherwise, all advisory services described in this brochure as performed by Denali are provided in Denali’s role as managing member of DC Funding.

As of December 31, 2010 Denali had approximately \$3.0 billion of bank loans under management across six leveraged, structured finance funds. Denali is currently managing five collateralized loan obligation funds (“CLOs”) and one hedge fund (the “Credit Opportunity Fund” or “COF”). Denali has full discretionary authority over all funds under DC Funding’s management.

The advisory services offered by Denali are tailored to the specific needs of each of DC Funding’s client funds, as set forth in the funds’ operative or offering documents. The funds are subject to strict guidelines on the types of securities they may own. At what stage a fund is in terms of its life cycle (i.e. warehouse, reinvestment or amortization period) may influence security selection. Day to day monitoring of a fund’s portfolio composition enables Denali to customize its services to the needs of each of DC Funding’s client funds.

Substantially all investment advice offered by Denali is within the bank loan market. Denali only advises entities with which DC Funding has entered into a management contract. Denali does not provide its services to any other entities.

FEES AND COMPENSATION

Management fees are negotiable per client. The management agreement between Denali and DC Funding calls for the management fees paid to Denali from DC Funding to be based on a percentage of assets under management (“AUM”). The percentage varies based upon the type of fund and quantity of assets Denali manages on behalf of DC Funding. The management fee for CLO assets ranges from .20% to .825%, per annum, of CLO AUM while the management fee for COF assets is .30%, per annum. The management agreement between Denali and DC Funding can be amended, or terminated, upon mutual consent.

Management fees are billed quarterly and paid in advance. DC Funding may obtain a prorated refund of any unearned management fee upon early termination. As managing member of DC Funding, Denali is authorized to pay DC Fundings’ expenses, including

the management fee. Denali authorizes the transfer of money from DC Funding to Denali to pay for management fees and reimbursable expenses.

Other expenses a client fund may pay besides management fees include, but are not limited too, interest expense on bank borrowings and fees for legal, accounting, and tax services.

PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT

DC Funding is entitled to receive incentive fees from funds under its management upon achieving fund-specific levels of return on investment. Conflicts may arise in the management of the funds, as Denali may have an incentive to favor funds for which the attainment of the incentive is more likely. As registered investment advisers both DC Funding and Denali acknowledge they have a fiduciary duty to act in the best interest of each fund regardless of compensation. Denali's credit policy ("CPM") and compliance manuals contain policies and procedures to mitigate any incentive to favor one fund over another fund.

Conflicts of interest may arise when deciding on how to allocate loan purchases to the funds under management by DC Funding. The CPM states that, in determining allocations of approved purchases, the Investment Committee ("IC") shall take into consideration all pertinent information concerning the specific characteristics of the asset being purchased in light of the investment parameters of each fund. When an asset to be purchased is equally attractive for more than one fund, the IC will generally allocate its anticipated assignment amount proportionally among the funds. Given limited availability, the anticipated assignment amount may be too small to proportionally allocate among all relevant funds, in which case the IC may prioritize the allocation amount first to the fund(s) whose investment parameters are best matched to the specific characteristics of the asset and second to the fund(s) which have the most available capital to invest. The IC may also take into account other similar opportunities concurrently available when allocating among its funds (especially when there are several similar trade opportunities) with an overall objective that each fund receive its proportional share of all relevant trade opportunities over time. Additionally, closed funds may receive preference of allocations over funds still in the warehouse phase.

Additional considerations may apply with respect to trades intended to be held for the short term only and sold at a profit. In the course of reviewing investment opportunities, Denali may determine that the anticipated market demand for a new loan offering vis-à-vis secondary trading levels for loans of similar type may provide an opportunity to realize a gain on the purchase, short term hold ("STH"), and subsequent sale of the loan. Denali vests the authority to execute STH trades in the Managing Directors or certain Directors. Due to the high market demand that gives rise to Denali's determination that a STH trade opportunity exists, Denali may not be allocated a sufficient amount to fill the order on behalf of all eligible funds. In such circumstances Denali allocates STH trades on a rotational basis among those funds for which STH trading is an express or implied

investment strategy and excludes any fund that expressly excludes STH trading from its investment strategy. Currently Denali Capital CLO VI, Ltd. and Denali Capital CLO VII, Ltd. are excluded on this basis. In addition, a fund will be bypassed in the rotation if the loan asset subject to the STH trade would be ineligible for investment by the fund. Limitations on discretionary trading by certain funds may also affect the allocation of STH trades. Finally, any fund that is a CLO that has not yet issued its permanent debt and equity securities will not be included in the STH rotation. This exclusion is based on the fact that DC Funding, or its affiliates, may be a direct beneficiary of any STH trade gains realized during the warehouse period because it typically has provided all or a substantial portion of the "first loss" capital in support of the temporary financing facility. Only non-proprietary funds are eligible to participate in the STH rotation.

TYPES OF CLIENTS

The typical fund managed by Denali is an offshore, non-public, closed-end, pooled investment fund often structured as either a CLO or hedge fund. While each fund is structured separately, the funds operate very similarly to one another. Each fund will be owned by a group of investors who will contribute typically 8% to 25% of the total capital structure. DC Funding is often, but not always, a member of this ownership group. Debt investors will contribute the remaining portion of the capital structure. The money provided by the debt and equity investors will be managed by Denali per each fund's operative agreement to purchase primarily portions of syndicated, below investment grade, commercial bank loans and selectively other assets. All funds currently managed by Denali are closed to new investors.

Denali participates in a unique environment which makes it impractical to establish a minimum client fund size requirement. Denali's decisions to enter into and maintain fund advisory engagements are primarily based on the amount and likelihood of receipt of management and incentive fees.

METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS

Denali will tailor its investment strategy, which is best summarized as long only, buy and hold, to each fund. Denali attempts to keep its funds reasonably fully invested at all times by purchasing primarily first lien senior secured non-investment grade bank loan obligations of large to middle market U.S.-based companies operating across numerous industries. These diverse investment portfolios are intended to help mitigate default risk and to enable its funds to profit from the interest rate arbitrage between the interest earned on the underlying investment pool and the interest paid on its borrowing source.

Denali targets small investment positions typically equal to .3% - 2.0% of an individual fund's total size in an effort to minimize individual obligor default risk.

Denali will generally invest only in bank loan obligations possessing the following core credit attributes:

- The transaction will involve a private company and be sponsored by a private equity sponsor firm having significant or meaningful capital invested or at risk or a transaction with a public or privately-held company represented by a financial intermediary.
- The borrower will have a professional management team with a combination of experience, balance and depth.
- The borrower will be a market leader or possess a demonstrable strategic advantage.
- The borrower will have a proven or provable record of earnings in line with the capital structure in place or proposed.
- The transactions will be generally structured along one or more of the following key financial ratios:
 - Pro forma Senior Debt/EBITDA average of 3.5x (4.0x upper range)
 - Pro forma Total Debt/EBITDA average of 5.0x (5.5x upper range)
 - Pro forma Cash Flow Interest Coverage greater than 2.0x
 - Pro forma Fixed Charge Coverage greater than 1.2x
 - Sub-debt plus equity at least 40% of total capitalization
 - Cash equity at least 20% of total capitalization

The investment strategies of Denali pose the following material risks to its funds under management and fund investors:

- **Limited Liquidity:** There is limited ability to sell the funds' investments as secondary markets often do not exist and the ability to transfer ownership to another entity is restricted. This risk may be heightened in times of economic downturn or in response to a specific economic event. In addition, loans to middle market companies trade less frequently than loans to larger companies and, in some instances, have no, or only a limited, trading market.
- **High Leverage:** The fund is highly leveraged and this may result in situations where the interest expense due is greater than interest income collected. The more subordinate the investor, the greater risk of non-payment.
- **Credit:** A borrower may not make required principal or interest payment under its borrowing terms.
- **Interest rate and prepayment:** Companies are likely to prepay their outstanding loans during periods of declining interest rates. Proceeds received from prepayment may be reinvested in a lower yielding investment.
- **Non-investment grade investments:** Non-investment grade loans will have greater credit and liquidity risk than investment grade obligations and are more likely to be impaired during periods of economic downturn.

Clients and their investors should be prepared to bear the risk of loss of principal when investing in bank loans.

Additional risk factors are set out in detail in the offering documents for the funds and are available to current investors in the CLOs and COF, which are closed to new investment.

DISCIPLINARY INFORMATION

Denali has no disciplinary information to report.

OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS

Denali has arrangements, with DC Funding, a related party, that are material to its advisory business. DC Funding is a registered investment adviser and is the portfolio manager under contract with the client funds. DC Funding has no employees. Denali's employees essentially perform all advisory services for the funds managed by DC Funding.

All limited partners of the COF with ownership levels in excess of thirty percent are entitled to appoint a representative to the COF's Advisory Board (the "AB"). The AB meets with Denali principals to discuss and make non-binding recommendations on the COF's investment portfolio and decisions regarding capital calls and distributions. Because AB membership is contingent on ownership levels, a potential conflict may arise between AB members and non-AB members. However, while AB members may have more input on the operating activities of the COF, ultimately all partners will share in the COF's economics proportionately to their ownership level. This prevents any AB member from benefiting differently than non-AB members.

CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING

In order to meet its obligations as a fiduciary, DC Funding and Denali have adopted a Code of Ethics (the Code), which incorporates general principles which all Denali employees are expected to uphold. As an investment adviser, Denali is a fiduciary of its funds. Accordingly, Denali has a fiduciary duty at all times to place the interests of its funds before the interests of Denali and all access persons.

In accordance with the Code, neither Denali nor a related person buys or sells for funds securities in which DC Funding has a material financial interest. Neither DC Funding nor a related person is permitted to invest in the same, or similar, securities that it recommends to funds.

Under the Code, all employees are deemed to be access persons and required to provide all personal securities transaction reports to Denali's compliance area. Access persons also must obtain the pre-approval of the compliance area before entering into trades involving initial public offerings or private placements. All employee personal securities transactions must be conducted in a manner consistent with the Code and avoid any

actual or potential conflicts of interest or any abuse of an employee's position. Employees may not take any inappropriate advantage of their positions at Denali. Information concerning the identity of securities and financial circumstances of funds and their investors must be kept confidential. Denali maintains a list of all companies with public debt or equity from whom it has received financial or other material information. This list of companies (Restricted List) is updated and available to all employees on a weekly basis. All employee brokerage accounts are monitored for any activity with companies on the Restricted List.

Employees are prohibited from accepting or giving a gift, favor, entertainment, special accommodation, or other item of value of more than de minimis value (\$200).

A copy of the Code is available to any fund or prospective fund client upon request. You may obtain a free copy of the Code by contacting Dave Dekker at 630-928-2570 or ddekker@denalicap.com.

BROKERAGE PRACTICES

Denali trades on behalf of DC Funding and its clients in bank loans on both a primary and secondary basis. A primary transaction occurs when an issue first comes to market, as a result of an acquisition, refinance or recapitulation of a company or business. Denali typically accesses a primary transaction through large commercial or investment banks, regional banks or specialty finance companies. In a primary transaction one organization is usually responsible for the syndication of the bank debt and as such is the party Denali negotiates the possible purchase. A secondary transaction involves one existing holder of the bank debt selling its position, in full or part, to another institution. These transactions usually occur through a trading desk whose function is to bring buyers and sellers together. Denali is from time to time both a seller and a buyer in the secondary market. As a result of Denali's long standing participation in this market sector, it believes it has more than adequate access to assets for each of its managed funds.

Denali has full discretionary authority to place trades on behalf of its clients. As a result, Denali is obligated to obtain best execution for client securities transactions. Best execution is generally described as a duty to execute securities transactions so that a client's total costs or proceeds are the most favorable under the circumstances. The Securities and Exchange Commission (the "SEC") has stated that, when seeking best execution, an adviser should consider the full range and quality of a broker-dealer's services in placing trades. Best execution therefore is not necessarily determined by the lowest possible commission costs, but rather by the best qualitative execution. Factors Denali may consider when selecting broker-dealers generally include price, execution risk, market conditions, and historical performance.

In placing specific orders to purchase and sell securities for its funds, Denali considers a number of factors in selecting the appropriate broker-dealer, such as:

- (i) determining which broker-dealers with whom Denali conducts business make an active market in the asset;
- (ii) determining what their respective current bid or offer prices, as applicable, are;
- (iii) comparing what, if any, assignment fees may be charged depending on which broker-dealer is selected;
- (iv) taking into account whether the quoted prices are immediately actionable (i.e. whether the broker-dealer actually owns and is ready to sell an asset, or is ready to confirm an order for purchase).

Denali may from time to time direct the purchase of a loan from, or the sale of a loan to, another fund managed by Denali in a combined transaction (a “Cross Trade”). Denali has established a policy on Cross Trade transactions which states that Cross Trade transactions must be conducted on an arm's-length basis and be at an established fair market value of the particular loan. Because of the nature of these transactions, Cross Trades present a potential conflict of interest. Denali will not conduct Cross Trade transactions with any fund in which DC Funding, Denali, or any affiliates or Members thereof, have an ownership interest unless Denali obtains the written approval of such funds third party fiduciary. Additional information regarding Denali's Cross Trade activities is available to any fund or prospective fund client upon request.

REVIEW OF ACCOUNTS

Weekly reviews of fund performance and portfolio composition are performed by middle and senior management to ensure each fund is managed in accordance with operative agreements. In addition to internally performed reviews, third party service providers such as administrators, accounting firms, and trustees independently review fund and advisory activities monthly to ensure further compliance with each fund's governing document.

Reports are distributed to each fund and its investors as required by each fund operative agreement. Middle and senior management perform a detailed review of all reports for accuracy and compliance prior to distribution. Reporting requirements differ by fund and range from detailed reports of underlying transactions to a summarized view of fund activity. Denali or third party service providers prepare quarterly investor letters, monthly return, and NAV reports. These documents may be distributed directly to investors by Denali or by the service provider.

CLIENT REFERRALS AND OTHER COMPENSATION

Neither Denali nor its related persons operate under any arrangement where it or they receive compensation or any economic benefit from a non-client for providing advisory services to a client.

In consideration for certain holders of a class of security in a CLO not initially managed by Denali nominating Denali for appointment as the successor to the previous collateral manager, Denali has agreed to share with such holders a substantial percentage of each

type of management fee paid by this CLO. These amounts are payable to such holders solely when the management fees are paid in cash from the CLO.

CUSTODY

As the general partner of the COF, DC Funding has custody of the fund. The COF and its investors receive account statements, prepared independently from Denali, directly from the administrator and/or the trustee. The COF and its investors should carefully review these account statements and are encouraged to compare these account statements with those statements and letters it receives from DC Funding or from Denali, on behalf of DC Funding. Audited financial statements prepared in accordance with Generally Accepted Accounting Principles (“GAAP”) are prepared for the COF and disseminated to COF investors within 120 days of the funds fiscal year end.

Denali does not have custody of the assets of the CLOs. Any cash and securities owned by the CLOs is maintained with trustees and can be used by the fund only according to defined reasons as outlined in each CLO’s operative agreements. The CLOs and their investors receive account statements, prepared independently from Denali, directly from the trustees. The CLOs and their investors should carefully review these account statements and are encouraged to compare these account statements with those statements and letters they receive from DC Funding or from Denali on behalf of DC Funding.

INVESTMENT DISCRETION

Denali has full discretionary authority over all of DC Funding’s client funds to operate within the parameters of each fund’s operative agreements. Denali performs a thorough review of the operative agreements of DC Funding’s clients and engages in day to day monitoring of fund performance and portfolio composition to ensure customization of its services to the needs of each of its clients.

VOTING CLIENT SECURITIES

Denali does not engage in typical proxy voting activities as defined by the SEC but considers voting on loan amendments, modifications, waivers, and other similar items to be similar to proxy voting. Denali has authority to vote on behalf of funds as granted to DC Funding within each fund management agreement.

The chief credit officer of Denali possesses the overall responsibility to ensure compliance with procedures relating to approval of amendments, modifications and waivers, and other similar items. All positions with respect to such items must be approved by the required individuals in accordance with Denali’s current Delegations of Authority and Pre-Funding and Amendment Authority matrices.

Denali’s general policy is to vote in favor of proposed amendments it believes are a necessary aspect of a business’ operations and/or that Denali believes will preserve or enhance the value of the investment for each fund. Denali must act as a fiduciary when voting on behalf of its funds. In that regard, Denali will seek to avoid possible conflicts

of interest in connection with voting. If a conflict of interest with respect to voting exists, Denali must either seek the client's informed direction or abstain from voting. Denali will not make any decisions as to whether to participate in or opt out of a class action involving securities in which clients are invested.

Additional information regarding Denali's voting policies and procedures and any specific voting decision are available upon request. Contact Dave Dekker at 630-928-2570 or ddekker@denalicap.com to obtain further information.

FINANCIAL INFORMATION

As of the date of this report, to the best of Denali's knowledge, no financial condition exists that is reasonably likely to impair Denali's ability to meet contractual commitments to the funds.