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Leveraged lending guidelines have set six times total leverage as the limit above which a loan would likely be criticized by examiners. Less noted by the media, but of growing interest to market players, are the components of leverage metrics; specifically, how the numerator (debt) and the denominator (cash flow) are being massaged to put the best face on increasingly leveraged transactions.

Let's look first at the debt definition: guidelines specify total debt to cash flow. That includes not only the loan being syndicated, but any other corporate debt whether bonds, subordinated debt, or even a holding company instrument. Holcos often get overlooked, but rating agencies consistently sweep any security or tranche with a coupon under the debt umbrella. That's because parent company debt is usually serviced by OpCo cash flows.

Also often missed is that the calculation includes committed debt. That means not only undrawn capacity under a revolving credit facility, but any additional debt allowable under the credit agreement. Leveraged borrowers often have baskets with built-in incremental capacity. Regulators assume they are drawn day one.

Ebitda is one of the most universal accounting concepts in corporate finance, but it is not actually defined under GAAP. Not being grounded in generally accepted accounting principles means Ebitda and its variants exist in a gray area when it comes to underwriting standards.

Any first-year lev fin analyst is familiar with "adjusted" Ebitda. The nature of these adjustments is as varied as the types of expenses incurred by private equity sponsors buying businesses. For example, if there are expected employee layoffs as part of a merger with an existing platform business, the cost of severance and transition expenses can be added back to Ebitda.

Another common "add-back" is costs of the deal itself. Also typical are plant closings or sale of real-estate at a loss.

Beyond expense padding, buyers scrutinize borrowers' sales profiles. If a significant new customer contract has been signed, revenue from that may be annualized to enhance cash flow. In some industries – co-location or data centers, for example – it is accepted practice to annualize the latest quarterly revenues coming from new centers to come up with higher pro forma Ebitda.

The concept of adding back "non-recurring" expenses is standard operating procedure, but has seen envelope-pushing in this toppy market. Some "one-time" charges are fairly well-scrubbed, like sale of a product line. More elusive are working capital items like receivable or inventory write-offs. One veteran credit pro we know dubs these "recurring non-recurring" charges.

Of course for regulated entities the game is to finesse Ebitda so that total leverage comes in below the magic six times threshold. Experienced loan buyers must be adept at figuring out which adjustments meet the sniff test and which don't. And as a gentle reminder, regulators warn they will "criticize situations in which EBITDA is defined in loan documents in ways that allow enhancements to EBITDA without reasonable support."

This column first appeared in the weekly newsletter of [Creditflux](), a leading global information source for the credit trading and investment market.