

# Sri Lanka Private-Sector Hospitals

## Positioned for Sustainable Growth

**Favourable Demographic Trends:** Sri Lanka's private hospitals are poised for strong growth, with one of the world's fastest-growing, ageing populations. Nearly 9% of the population was 65 years of age and over at end-2014. This is likely to double by 2030, and the public sector alone has insufficient capacity to handle the growth.

Demand for private health care is also driven by rising per capita income, enabling more people to afford paid healthcare. Sri Lanka is just a few years away from reaching the higher-middle-income band, under the current growth trajectory. However, per capita healthcare spend of USD102 (2013) is significantly below the average per capita for higher-middle-income countries at USD465, highlighting the growth potential in the medium term.

**Rising Incidence of NCDs:** Non-communicable diseases (NCDs) are on the rise, owing to the ageing population and dietary and lifestyle changes resulting from rapid urbanisation. In 2012, 71% of the deaths were on account of chronic NCDs. Sri Lanka's Health Ministry estimates that 25% of the adult population is already suffering from hypertension, and half of the population is likely to suffer from diabetes by 2050. These dynamics should be a catalyst for strong demand, given that treatment of NCDs involves long hospital stays and advance procedures.

**Growth Through Medical Tourism:** Expanding the global medical tourism market is a key growth driver for the private sector. Most have already upgraded some of their facilities to international standards to cater for this market, and are treating an increasing number of patients from countries such as India, the Maldives, Bangladesh and the Seychelles.

**Low Medical Insurance Penetration:** One key impediment for private-sector growth is the very low penetration in medical insurance. Only 4% of the private healthcare spend was attributable to insurance in 2013. A meaningful increase in medical insurance coverage would result in more patients opting for paid healthcare by shifting away from state-run hospitals.

**Private-Sector Expansion Essential:** Congestion at public hospitals and low government investment has created a pressing need for greater private-sector participation. Private-sector investment should also be supported by prevailing gaps in the public system – including diagnostics, laboratory services and outpatient care, where there is low public service.

The top five private hospitals account for 45% of the private-sector bed capacity, with most investing in further capacity expansion. A favourable demand outlook, strong operating cash flow generation and modest margins in the sector promotes continued investment by these leading players, which is supported by their strong-to-moderate credit profiles.

**Skilled Professionals – Key Constraint:** Shortage of skilled medical professionals is a key issue, crucial to attracting patients to the private sector. Liabilities arising from medical negligence and poor quality of care remain risks, but are mitigated to an extent by a legal and regulatory system which is still evolving in this regard.

**Public Sector Still Dominates:** Sri Lanka's hospitals are dominated by the public sector due to government's policy of providing free universal healthcare. The public sector accounted for 73% of the hospitals and 93% of the available bed capacity as of end-2014, while its share of patient admissions and outpatient visits was >90%. However, private hospitals have been able to boost their share in hospital beds through capacity expansion at a compound annual growth rate (CAGR) of 21% over the last four years, compared with 10% for the public sector.

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### Industry Structure

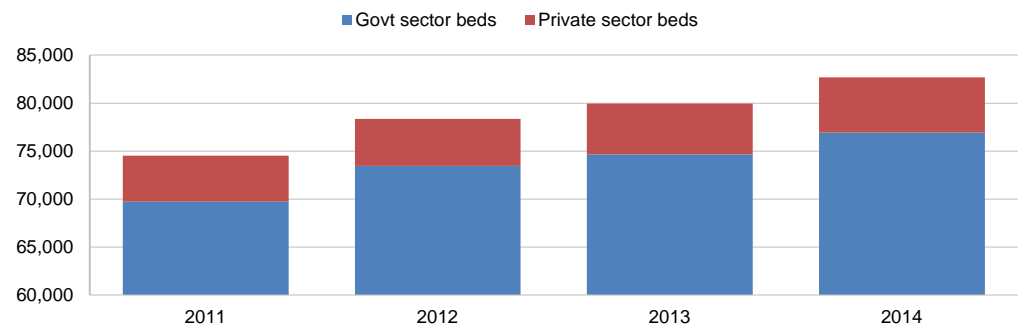
According to data provided by the Central Bank of Sri Lanka, the public sector accounted for 73% of the hospitals and 93% of the available bed capacity in Sri Lanka, while handling over 90% of the total patient admissions and outpatient visits to hospitals as of end 2014.

The private sector consisted mainly of a few leading hospital chains and a large number of small regional players. The capacity concentration was moderate, with the top five hospitals accounting for ~45%.

Public-sector hospitals are engaged in both curative and preventive care, while the private sector is focused mainly on the former – in light of the commercial viability of providing such care. A study published by the Institute for Health Policy in 2015 concluded that the quality of treatment and management of inpatient care was actually better in the public sector despite being available at a lower cost. According to the same survey, the quality of assessment and investigation was more comparable across the two providers.

Figure 1

#### Hospital Bed Mix



Source: Central Bank of Sri Lanka

Sri Lanka’s total healthcare expenditure as a percentage of total GDP is one of the lowest in the world at 3.24% (as of end-2013), of which only 44% was spent by the government despite a free universal health care system. Patients who are treated at state hospitals are still required to obtain certain drugs and medical tests at their own expense, which has resulted in private healthcare spend remaining above government spend. Of the private spend, 83% constituted out-of-pocket spend as medical insurance penetration is still at a very nascent stage in Sri Lanka.

Figure 2

#### Healthcare Indicators 2013

Indicator	Sri Lanka (BB-)	Bangladesh (BB-)	Vietnam (BB-)	Lower/middle income	Upper/middle income	World
Total healthcare spend as a % of GDP	3.24	3.73	5.95	4.25	6.28	9.94
Public healthcare spend as a % of GDP	1.43	1.31	2.49	1.59	3.51	5.94
Per capita healthcare spend (USD)	102	32	111	82	465	1,048
Out-of-pocket healthcare spend as % of private healthcare spend	82.99	93.03	85.02	86.98	72.43	46.10

Source: World Bank

Yet healthcare per capita in Sri Lanka is significantly higher than in most other Asian and middle-income countries. This is reflected in high hospital bed penetration of 4.0 beds per 1,000 population – much higher than in similar developing countries, and more in line with developed countries where the bed penetration is around 5.0 (2011).

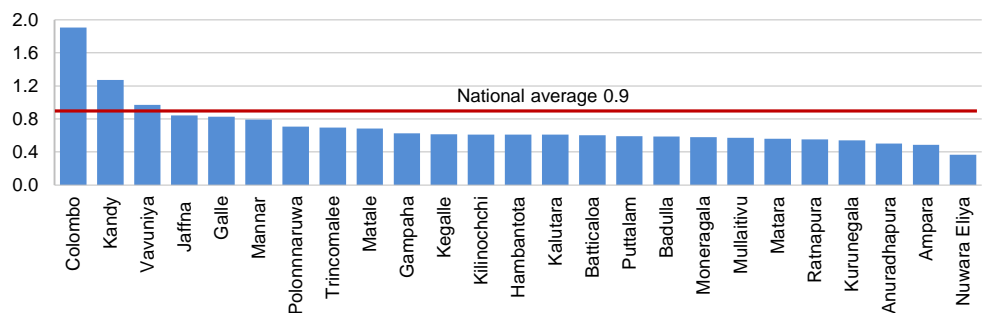
The bed penetration is unequal across the country, with 33% of the population having ~2 beds per 1,000 people, highlighting the need for expansion in selected densely populated districts

such as Gampaha, Kalutara and Kegalle. Most private-sector beds are concentrated in the Western province due to the higher physician density in the region.

Sri Lankan hospitals lag most countries in terms of human and technological resources; physician penetration per 1,000 population was 0.9 at end-2014 compared with a world average of 1.49 in 2013; and availability of medical devices such as magnetic resonance imaging (MRI) and computed tomography units (CT scans) was low at 0.4 and 1.7, respectively, per 1,000 population. Furthermore, physician distribution is highly skewed towards the Colombo district, while 73% of the population is faced with a physician density much below the national average – highlighting the significant constraint faced by the industry.

Figure 3

**Physician Density per 1,000 Population**



Source: Central Bank of Sri Lanka

**Regulation**

The private-hospital sector is regulated by the Private Health Services Regulatory Council established under the Private Medical Institutions Registration Act, No.21 of 2006. The Act controls the registration, regulation, monitoring and inspection of private medical institutions.

**Growth Dynamics for the Private Sector**

The Sri Lankan hospital sector as a whole – and private hospitals in particular – is strongly positioned to benefit from favourable macro and demographic trends in the country. The administration which came into power in early 2015 has made it a priority to improve the healthcare system, and has allocated 3% of GDP for healthcare in its 2015 budget compared with 1.4% in 2014. We believe this will provide an incentive for the private sector to boost investment in order to keep pace with the public sector.

Sri Lanka has one of the highest and fastest-aging populations in the world. The number of people over 65 years, at 8.7% of the population (2004: 6.9%), is expected to almost double by 2030, requiring significant expansion across the board in the healthcare sector. A special focus is on geriatrics, which most hospitals are not equipped to handle. The private sector would have a large role to play in plugging the demand/supply gap, as government’s capex on healthcare has amounted to only a 4% CAGR over the past seven years.

Sri Lanka’s current GDP per capita of USD3,600 falls in the lower-middle-income category, and has grown at a CAGR of 13% in the last 10 years. Personal care and health expenses have also increased – to 5.3% of total household expenditure in 2013 from 4.3% in 2006 – as people become more health-conscious as income levels rise. Should Sri Lanka continue its current GDP growth trajectory of 6%-7% per annum, it should reach the level of upper-middle-income economies in the next two-three years. Per capita healthcare expenditure has averaged around USD465 for these economies (compared with USD102 for Sri Lanka), highlighting the growth potential for the country’s healthcare sector in the medium term.

Fitch believes more people will opt for private healthcare, armed with increased spending capacity – given the convenience and speed of service. The fact that public healthcare is free means that state hospitals tend to be over-crowded, with long waiting lists for surgeries and treatment. Private hospitals, on the other hand, provide the ease of consultations and treatment at one's own convenience – but at a price.

Another key driver for growth is the increase in NCDs, which require long hospital stays. NCDs are the leading cause for mortality, morbidity and disability in the country, and a direct consequence of rapid urbanisation (18.3% in 2013 versus 15.1% in 2011) and the rise in per capita income which has led to life style and dietary changes. Based on the latest data published by the Health Ministry, 71% of the annual deaths in the country in 2012 was attributable to chronic NCDs; with cardiovascular diseases accounting for 29.6%, followed by diabetes (9.4%), chronic respiratory diseases (8.5%), and cancer (3.9%).

The incidence of NCDs is increasing with the aging population. According to Health Ministry estimates, ~25% of the adult population already suffer from hypertension while 50% is expected to suffer from diabetes by 2050. These trends provide an opportunity for private players to step in and improve their presence in the areas of oncology, cardiology, endocrinology and urology, as the public sector alone will not be able to cater to the growing demand. Furthermore, the rise in NCDs also boosts demand for laboratory services where the private hospitals already have a strong presence.

One of the key constraints to growth in the private-sector hospitals has been the low penetration in medical insurance policies. As of end-2013, only 4% of the private healthcare spend was funded by insurance, and the number of medical insurance policies in the country amounted to a mere 13,876 by end-2014. However, rising income levels and a rapidly aging population mean that the tendency to obtain health cover is high – which should act a positive driver for the industry in the medium term.

Medical tourism represents another growth avenue for private hospitals, which is still at a very early stage in Sri Lanka. The global medical tourism market was worth USD38-55bn in 2014, according to Patients Beyond Borders, based on 11 million tourists spending USD3,500-5,000 per visit. The key consideration for tourists in selecting a destination for treatment is the quality of care, followed by cost effectiveness. According to industry experts, Sri Lanka has the human resource capability in terms of overseas-trained physicians and English-speaking support staff to cater to this market, but may have to improve its facilities and treatment to the standards offered by popular regional destinations such as Singapore and Thailand. Most of the leading private hospitals have already started treating patients from abroad; and consequently, tourists have accounted for ~15% of the patients treated by private hospitals.

## Risks

The biggest risk faced by the private hospitals is the shortage of trained medical practitioners. Most specialist consultants are with the public sector, and the inability of private hospitals to attract the services of such consultants could significantly reduce the demand for private hospitals. Specialised consultants opt for the public sector because of better exposure, opportunity for further training, and for benefits such as tax free income. Competition among private players to attract skilled staff has resulted in significant cost escalations in the industry in the last few years.

The risk of liabilities arising from medical malpractices and negligence is substantial, though mitigated to an extent by a legal and regulatory system which is still evolving.

## Key Players

In the private sector, the top five players – the Dr Neville Fernando Teaching Hospital (NFTH), Asiri Hospital Holdings PLC (Asiri), Nawalok Hospitals PLC (Nawaloka), Durdans Hospitals (Durdans) and The Lanka Hospitals – accounted for ~45% of the private-sector bed capacity at-end 2014, with NFTH the market leader with 1,002 beds. The top five are concentrated mainly in Colombo and its suburbs, but some have expanded their reach to districts with strong growth potential such as Gampaha, Matara and Kandy.

The competition among the top hospitals is based mainly on the quality and reputation of the physicians they are able to attract, and to a lesser degree on pricing and facilities. Specialisation among the private hospitals is limited, as most hospitals tend to provide a full suite of services including laboratory services, outpatient care and post-operative support. Asiri operates the largest laboratory network in the country, with close to a 60% market share, followed by Nawaloka, Lanka Hospitals and Durdans.

The high fixed-cost base means that the profitability of the private hospitals is susceptible to bed occupancy levels – which are generally high, given the strong demand environment. Profitability is also complemented by ancillary services provided by the hospitals such as laboratory services and outpatient care, which generally tend to have wider margins. The four listed hospitals in Sri Lanka (Asiri, Nawaloka, Durdans and Lanka Hospitals) reported revenue growth of 10% in FY15, while EBITDA margins ranged from the mid-teens to the high 20s, with the divergence resulting from revenue mix, occupancy levels and efficiency measures. Most hospitals have experienced a significant increase in their staff costs in the last few years, stemming from a shortage in skilled staff.

The credit profile of the listed companies ranges from strong to modest, owing to their respective expansion pipeline. The Lanka Hospitals and Durdans have maintained strong balance sheets in the absence of any ongoing expansions, while Nawaloka and Asiri – which are in the midst of significant capacity expansion drives – are carrying stretched balance sheets which we expect to persist in the medium term until the projects are completed. We believe continuous expansion by existing players is warranted, provided it does not unduly stretch the companies' balance sheets

Figure 4  
**Nawaloka Hospitals PLC**  
 (LKRm, as of 31 March 2015)

**Summary of operations**

LTM net revenue	4,602
LTM EBITDA	750
LTM EBITDA margin (%)	16.3
No. of hospital beds	475

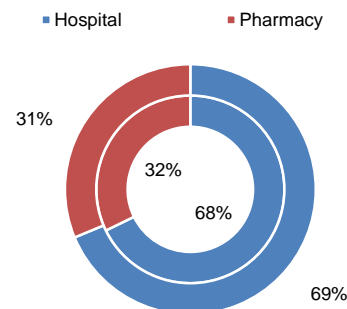
**Liquidity analysis**

Cash and short term investments	454
Unutilised credit lines	n.a.
Total liquidity	454
LTM FCF	-1,865
Debt falling due within one-year <sup>a</sup>	359

<sup>a</sup> Excluding roll over debt

**Segment Revenue Breakdown**

Outer ring: FY15  
 Inner ring: FY14



Debt maturities	FY16	FY17	FY18	FY19	FY20	>FY20	Total
Bank term loans and revolving credit facilities	994	309	309	309	343	-	2,263
Debentures	-	-	-	1,029	266	185	1,480
Finance leases	8	8	8	8	8	84	124

**Strengths and weaknesses**

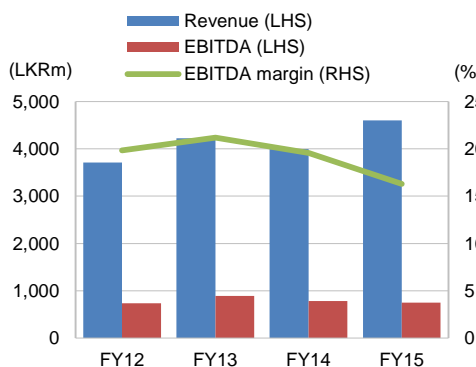
**Strengths**

Strong brand name and long operating history attracts the best consultants in the country  
 One of the few large hospitals to have ventured in to geographical expansion with plans to open a chain of regional hospitals  
 Specialisation in many therapeutic groups, and a pioneer in introducing new devices and treatment  
 Strong network of laboratory services spread across the country

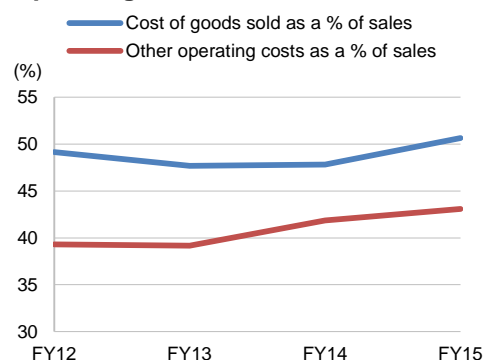
**Weaknesses**

High leverage, owing to significant expansion plans in the medium term  
 Contracting EBITDA margins stemming from rising operating costs including escalating staff costs

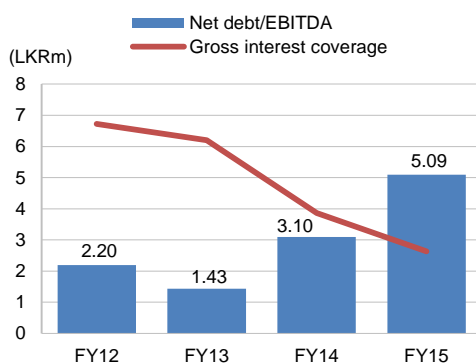
**Revenue and EBITDA FY12-FY15**



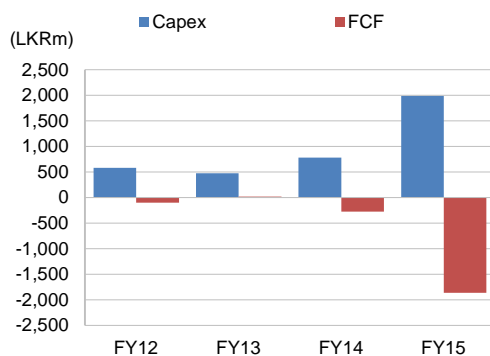
**Operating Costs FY12-FY15**



**Leverage and Coverage FY12-FY15**



**Capex and FCF FY12-FY15**



Source: Company filings and Fitch calculations

Figure 5  
**Asiri Hospital Holdings PLC**  
(LKRm, as of 31 March 2015)

**Summary of operations**

LTM net revenue	8,547
LTM EBITDA	2,491
LTM EBITDA margin (%)	29.1
No. of hospital beds	600

**Liquidity analysis**

Cash and short-term investments	1,247
Unutilised credit lines	n.a.
Total liquidity	1,247
LTM FCF	597
Debt falling due within one-year <sup>a</sup>	1,095

<sup>a</sup> Excluding roll over debt

**Debt maturities**

	FY16	FY17	FY18	FY19	FY20	>FY20	Total
Bank term loans and revolving credit facilities	1,347	1,045	1,045	1,045	1,045	2,852	8,380
Debentures	-	-	-	-	-	-	-
Finance leases	4	4	4	4	4	18	38

**Strengths and weaknesses**

**Strengths**

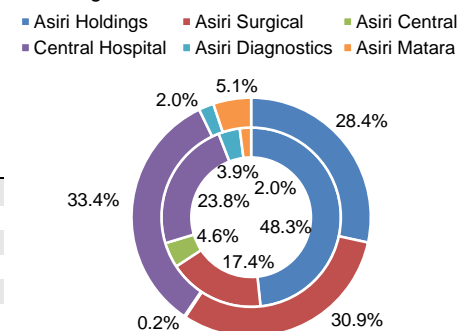
- Second-largest private hospital chain in Sri Lanka; with a bed strength of 600+, a solid brand name and state-of-the-art facilities
- One of the few large hospitals to have ventured into geographical expansion with hospitals in the southern and central regions
- Higher profitability compared with peers, due to a presence in high-margin businesses such as diagnostics and cost efficiencies
- Operates the largest laboratory network in the country, with close to 60% market share

**Weaknesses**

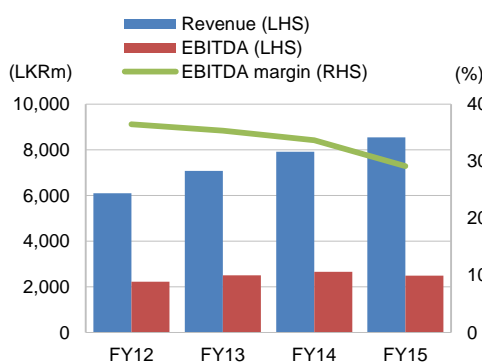
- Rising leverage owing to significant refurbishment and expansion plans in the medium term
- Contracting EBITDA margins stemming from rising operating costs including escalating staff costs
- Dividend up-streaming pressure from the parent Softlogic Holdings PLC.

**Segment Revenue and EBIT Breakdown FY15**

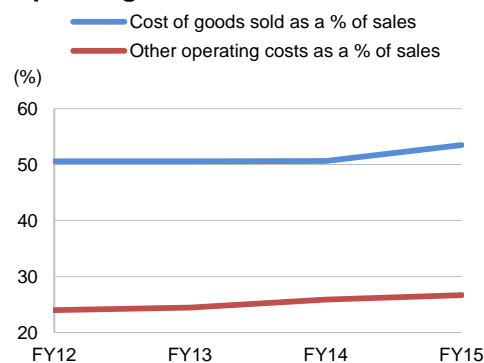
Outer ring: Revenue  
Inner ring: EBIT



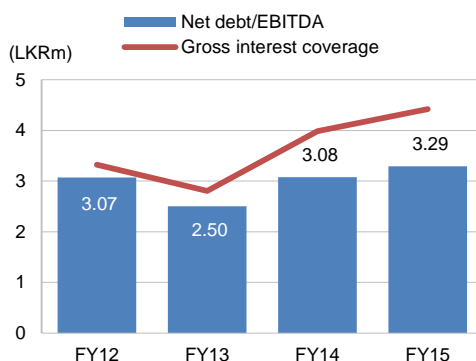
**Revenue and EBITDA FY12-FY15**



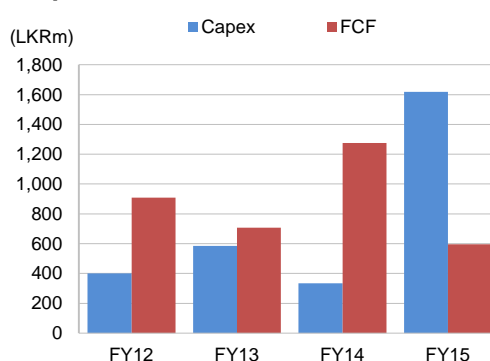
**Operating Costs FY12-FY15**



**Leverage and Coverage FY12-FY15**



**Capex and FCF FY12-FY15**



Source: Company filings and Fitch calculations

Figure 6  
**Durdans Hospital**  
 (LKRm, as of 31 March 2015)

**Summary of operations**

LTM net revenue	4,754
LTM EBITDA	657
LTM EBITDA margin (%)	13.8
No. of hospital beds	300

**Liquidity analysis**

Cash and short-term investments	307
Unutilised credit lines	n.a.
Total liquidity	307
LTM FCF	272
Debt falling due within one-year <sup>a</sup>	404

<sup>a</sup> Excluding roll over debt

**Debt maturities**

	FY16	FY17	FY18	FY19	FY20	>FY20	Total
Bank term loans and revolving credit facilities	718	215	164	57	7	-	1,161
Debentures	29	30	-	-	-	-	59
Finance leases	1	1	1	0	-	-	3

**Strengths and weaknesses**

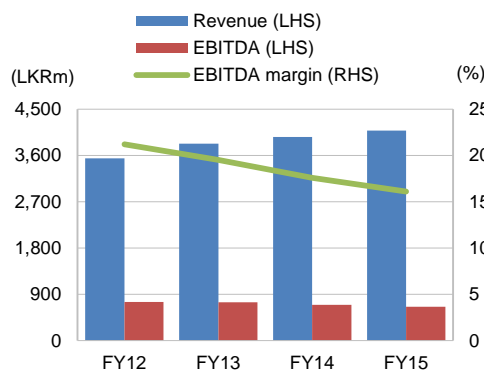
**Strengths**

Strong brand name and long operating history attracts the best consultants in the country  
 Strong balance sheet supports expansions, and investments to benefit from favourable industry dynamics  
 Stable FCF generation

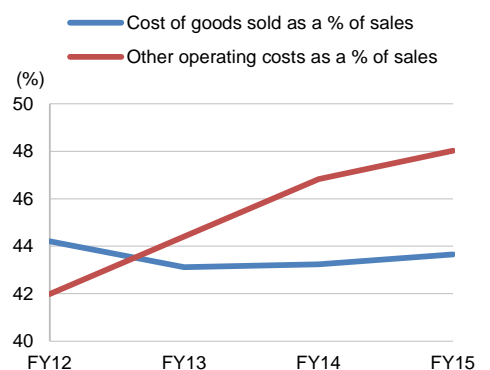
**Weaknesses**

Operations are concentrated in one single location, resulting in very limited geographic diversification  
 Contracting EBITDA margins on the back of escalating operating costs  
 Low visibility on expansion compared with other large players

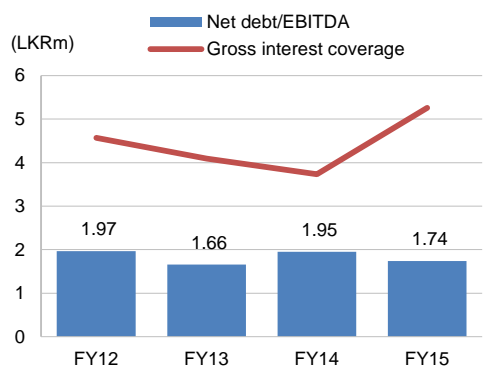
**Revenue and EBITDA FY12-FY15**



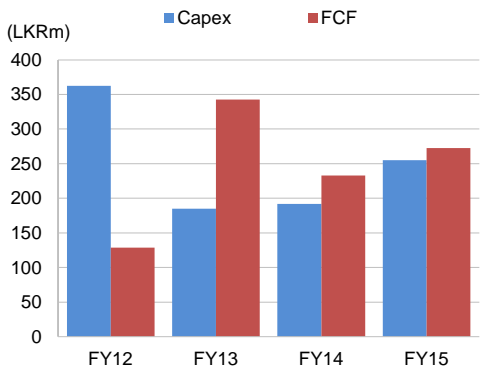
**Operating Costs FY12-FY15**



**Leverage and Coverage FY12-FY15**



**Capex and FCF FY12-FY15**



Source: Company filings and Fitch calculations



Figure 7  
**The Lanka Hospital Corporation PLC**  
 (LKRm, as of 31 March 2015)

**Summary of operations**

LTM net revenue	4,754
LTM EBITDA	702
LTM EBITDA margin (%)	14.8
No. of hospital beds	350

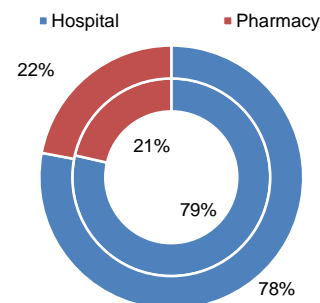
**Liquidity analysis**

Cash and short-term investments	995
Unutilised credit lines	n.a.
Total liquidity	995
LTM FCF	-70
Debt falling due within one year <sup>a</sup>	198

<sup>a</sup> Excluding roll over debt

**Segment Revenue Breakdown**

Outer ring: FY15  
 Inner ring: FY14



**Debt maturities**

	FY16	FY17	FY18	FY19	FY20	>FY20	Total
Bank term loans and revolving credit facilities	198	-	-	-	-	-	198
Debentures	-	-	-	-	-	-	-
Finance leases	-	-	-	-	-	-	-

**Strengths and weaknesses**

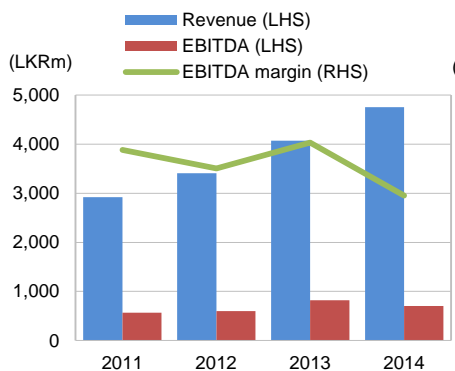
**Strengths**

Strong linkages with international medical institutions and consultants  
 Strong balance sheet supports expansion, and investment to benefit from favourable industry dynamics  
 Strong presence in the medical tourism industry  
 Venture into diagnostics services with the establishment of the most advanced medical laboratory in Sri Lanka

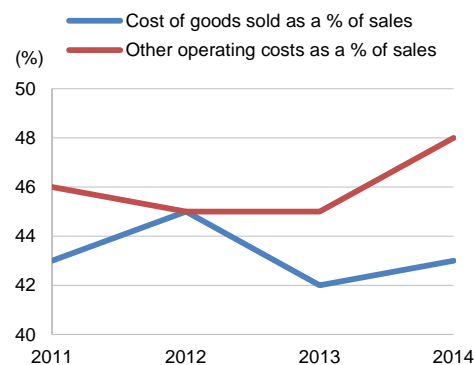
**Weaknesses**

Operations are concentrated in one single location, resulting in very limited geographic diversification  
 Low visibility on expansion compared with other large players

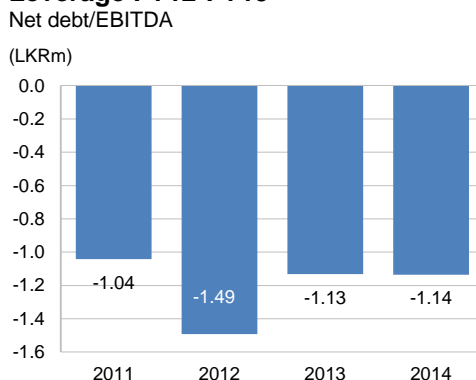
**Revenue and EBITDA FY12-FY15**



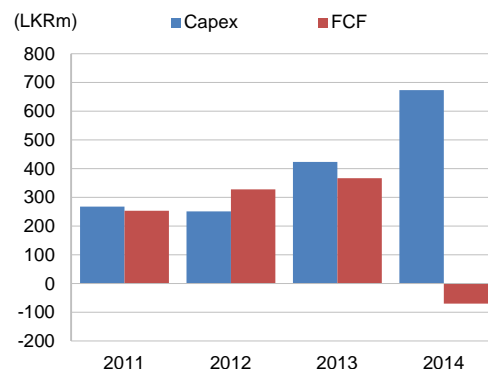
**Operating Costs FY12-FY15**



**Leverage FY12-FY15**



**Capex and FCF FY12-FY15**



Source: Company filings and Fitch calculations

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