AFTER NINE YEARS, TESCO GIVES UP ON CRACKING CHINA ALONE

(Reuters) - After nine years in China, British supermarket firm Tesco is to fold its unprofitable operation into a state-run company as a minority partner, becoming the latest foreign retailer to give up on trying to crack China on its own.

Lured by the prospect of a rapidly growing middle class in the world's second-biggest economy, many foreign firms have waded into China's retail market only to find they lack local expertise, particularly in building supplier relationships.

The world's No.3 retailer said on Friday it was in talks to team up with China Resources Enterprise Ltd (CRE), a move that follows decisions to abandon the United States and Japan and focus on investing in its British home market.

The move would cede control, with Tesco having just a 20 percent stake, but bring their combined market share close to market leader Sun Art Retail Group Ltd.

Tesco would combine its 131 outlets with CRE's Vanguard unit, which operates 2,986 mainly hypermarkets or supermarkets across China and Hong Kong. The combined business will have some 10 billion pounds ($15.6 billion) in sales, dwarfing the 1.43 billion pounds Tesco generated on its own in China last year.

Retail analysts said the decision was effectively a surrender by Tesco, showing the difficulty foreign companies have in negotiating with suppliers and regulators in a fast-growing but tricky market.

"This may look win-win, but in reality, Tesco is saying 'I can't figure out China'," said one Hong Kong-based M&A banker.

"Tesco has been struggling in China and has been losing money. Similar to Carrefour, they had issues in their home market which they had to resolve," he said.

Tesco is expected to pay CRE a few hundred million pounds in the deal, which would make the combined business the leading retailer in seven of the eight highest spending areas in China.

China has proven to be conundrum for many foreign retailers.

The world's biggest and second biggest retailers, Wal-Mart Stores Inc and French retailer Carrefour SA are for now slugging it out alone, although there have been suggestions that Carrefour too could be seeking a local partner.

Wal-Mart, with 380 stores, plans to open another 100 in the next three years. Carrefour, with 70, is targeting 20 new openings a year.

Germany's Metro AG said in January it was pulling out of the consumer electronics business in China while Home Depot Inc said last year it would close all seven of its big-box home improvement stores.

"Tesco... finally finds a big giant to salvage them," said Kenny Wu, an analyst at Societe Generale Ji-Asia in Hong Kong, adding that the deal also works for CRE which is keen to expand its market share and has the cash to do so.

HOME MARKET FIRST

The move follows steps by Tesco to retreat from international expansion and focus on its British home market.

In April Tesco posted its first profit fall in two decades, wrote down the value of its global operations by $3.5 billion and confirmed plans to exit its loss-making business in the United States after five years trying to crack the market.

In 2012 the firm ended a nine-year attempt to compete in Japan's tough retail market, effectively paying Aeon Corp, the country's No.2 general retailer, to take its loss-making business there off its hands.

At home, where Tesco makes about two thirds of its revenues, it is pumping 1 billion pounds into store revamps and new food ranges to revitalize a business that lost ground to rivals and suffered from weak demand for general merchandise, as cash-strapped Britons cut back on discretionary spend.

In China, where Tesco makes around 2 percent of sales, the hypermarket industry is likely to grow to 863.8 billion yuan ($141 billion) by 2015, from an estimated 659.6 billion yuan in 2013, according to Euromonitor.

"Its partner brings formidable scale and local access, so it is hard to fault the logic of the move, even if it reads badly for the initial gung-ho expansion into China under previous management," independent retail analyst Nick Bubb said.

Sun Art, a joint venture between Taiwan conglomerate Ruentex Group and privately held French retailer Groupe Auchan SA, currently has a 13.6 percent market share in China. CRE and Wal-Mart each have about 10.9 percent, while Carrefour has 6.9 percent and Tesco 2.4 percent.

If Carrefour is on the lookout for a partner in China, the Tesco tie-up may now make that more difficult to achieve.

"It does seem to close down the options for Carrefour," Exane BNP analyst Andrew Gwynn said. "That's not to say there aren't other potential partners but clearly Carrefour has also been looking for someone to help share."

The deal also comes as Asia's richest man Li Ka-shing is considering selling his Hong Kong supermarket business, worth up to $4 billion. Wal-Mart is considering a bid, people familiar with matter have said, but the Tesco deal has apparently ruled out interest from CRE, according to some bankers.

CRE shares rose 7.8 percent to HK$25.70, outpacing a 0.7 percent rise in benchmark Hang Sengshare index. Tesco shares were up 0.56 percent at 0738 ET.

(Additional reporting by Christian Plumb in Paris; Editing by Peter Graff)