

PECO II INC
Form DEF 14A
April 17, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Under Rule 14a-12

PECO II, INC.

(Name of Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Edgar Filing: PECO II INC - Form DEF 14A

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1)

Title of each class of securities to which transaction applies:

(2)

Aggregate number of securities to which transaction applies:

(3)

Per unit price or other underlying value of transaction computed pursuant to Exchange

Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state

how it was determined):

(4)

Proposed maximum aggregate value of transaction:

(5)

Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1)

Amount Previously Paid:

(2)

Form, Schedule or Registration Statement No:

(3)

Filing Party:

(4)

Date Filed:

PECO II, INC.

1376 STATE ROUTE 598

GALION, OHIO 44833

April 17, 2009

TO PECO II, INC. SHAREHOLDERS:

This year's Annual Meeting of Shareholders of PECO II, Inc. will be held at 9:00 a.m., local time, Tuesday, May 19, 2009, at St. Joseph's Activity Center, 135 North Liberty Street, Galion, Ohio.

As in the past, there will be an informal discussion of our activities, during which time your questions and comments will be welcomed.

We hope that you are planning to attend the annual meeting personally, and we look forward to seeing you. Whether or not you expect to attend in person, the return of the enclosed proxy as soon as possible would be greatly appreciated and will ensure that your shares will be represented at the annual meeting. If you do attend the annual meeting, you may, of course, withdraw your proxy should you wish to vote in person.

On behalf of the directors and management of PECO II, I would like to thank you for your continued support and confidence.

Sincerely yours,

JOHN G. HEINDEL

Chairman of the Board, President,

*Chief Executive Officer, Chief Financial Officer
and Treasurer*

PECO II, INC.

1376 STATE ROUTE 598

GALION, OHIO 44833

NOTICE OF THE ANNUAL MEETING OF SHAREHOLDERS

NOTICE IS HEREBY GIVEN that the Annual Meeting of Shareholders of PECO II, Inc. will be held at St. Joseph's Activity Center, 135 North Liberty Street, Galion, Ohio, on Tuesday, May 19, 2009, at 9:00 a.m. local time, for the following purposes:

1.

To elect three directors in Class III for three-year terms and until their successors are duly elected and qualified; and

2.

To consider and act upon any other matters which may properly come before the annual meeting or any adjournment or postponement thereof.

Holders of common shares of record at the close of business on April 6, 2009 are entitled to receive notice of and to vote at the annual meeting. Shareholders may obtain directions to the annual meeting by visiting the Company's website: www.peco2.com.

Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to be Held on May 19, 2009: The proxy statement and annual report to security holders are available at www.peco2.com.

By Order of the Board of Directors,

GUY KEVIN BORDERS

*Vice President of Marketing & Product Development
and Secretary*

April 17, 2009

**Please fill in and sign the enclosed proxy and
return the proxy in the enclosed envelope.**

PECO II, INC.

1376 STATE ROUTE 598

GALION, OHIO 44833

PROXY STATEMENT

Mailed on or about April 17, 2009

Annual Meeting of Shareholders to be held on May 19, 2009

This proxy statement is furnished in connection with the solicitation of proxies by our Board of Directors to be used at our Annual Meeting of Shareholders to be held on May 19, 2009, and any adjournment or postponement thereof. The time, place, and purposes of the annual meeting are stated in the notice of annual meeting of shareholders, which accompanies this proxy statement.

The accompanying proxy is solicited by our Board of Directors. All validly executed proxies received by our Board of Directors pursuant to this solicitation will be voted at the annual meeting, and the directions contained in the proxies will be followed in each instance. If no directions are given, the proxy will be voted FOR the election of the three nominees for director in Class III listed on the proxy, and, with respect to any other matter that properly comes before the meeting, the proxy holders will vote as recommended by the Board or at their discretion.

Any person giving a proxy pursuant to this solicitation may revoke it. You may, without affecting any vote previously taken, revoke a proxy by giving notice to us in writing or in person at the annual meeting or by a duly executed proxy bearing a later date.

The expense of soliciting proxies, including the cost of preparing, assembling and mailing the notice, proxy statement and proxy, will be borne by us. We may pay persons holding shares for others their expenses for sending proxy materials to their principals. In addition to solicitation of proxies by mail, our directors, officers and employees, without additional compensation, may solicit proxies by telephone, facsimile and personal interview. We also may retain a third party to aid in the solicitation of proxies.

VOTING RIGHTS

The record date for determination of shareholders entitled to vote at the annual meeting was the close of business on April 6, 2009. On that date, we had 2,832,853 common shares, without par value, outstanding and entitled to vote at the annual meeting. Each common share is entitled to one vote.

At the annual meeting, in accordance with the General Corporation Law of Ohio and our Second Amended and Restated Code of Regulations, the inspectors of election appointed by our Board of Directors for the annual meeting will determine the presence of a quorum and will tabulate the results of shareholder voting. As provided by the General Corporation Law of Ohio and our Second Amended and Restated Code of Regulations, holders of shares entitling them to exercise a majority of the voting power of the company, present in person or by proxy at the annual meeting, will constitute a quorum for such meeting. The inspectors of election intend to treat properly executed proxies marked abstain as present for these purposes.

Nominees for election as directors receiving the greatest number of votes will be elected directors. Votes that are withheld or broker non-votes in respect of the election of directors will not be counted in determining the outcome of the election. Pursuant to our Amended and Restated Articles of Incorporation, shareholders do not have cumulative voting rights.

Pursuant to our Second Amended and Restated Code of Regulations, all other questions and matters properly brought before the annual meeting will be decided, unless otherwise provided by law, by our Amended and Restated Articles of Incorporation or by our Second Amended and Restated Code of Regulations, by the vote of the holders of a majority of the shares entitled to vote thereon present in person or by proxy at the annual meeting. In voting for such proposals, votes may be cast in favor, against or abstained. Abstentions will count as present for purposes of the item on which the abstention is noted and will have the effect of a vote against. Broker non-votes, however, are not counted as present for purposes of determining whether a proposal has been approved and will have no effect on the outcome of any such proposal. Please note that your broker or nominee may not be permitted

to exercise voting discretion with respect to certain matters to be voted on at the annual meeting. As a result, if you do not provide your broker or nominee specific instructions, your shares may not be voted in such matters.

SHARE OWNERSHIP OF PRINCIPAL HOLDERS AND MANAGEMENT

The number of shares beneficially owned by each shareholder is determined under rules issued by the Securities and Exchange Commission. This information is not necessarily indicative of beneficial ownership for any other purpose. Under these rules, beneficial ownership includes any shares as to which the individual or entity has sole or shared voting power or investment power as of the measurement date and any shares as to which the individual or entity has the right to acquire beneficial ownership within 60 days after such measurement date, through the exercise of any stock option or other right. Unless otherwise indicated, each person named below has sole voting power and investment power with respect to the number of shares set forth opposite his or her respective name.

Ownership of Common Shares by Principal Shareholders

The following table shows information regarding beneficial ownership of our common shares as of February 1, 2009, unless otherwise indicated, by each person or group which is known by us to own beneficially more than 5% of our common shares.

| Name and Address of Beneficial Owner ⁽¹⁾ | Common Shares Beneficially Owned | Percent Owned |
|---|---|------------------|
| Delta International Holding Ltd. ⁽²⁾ | 474,037 | 16.7% |
| Austin W. Marx and David M. Greenhouse ⁽³⁾ | 353,082 | 12.5% |
| Skiritai Capital LLC ⁽⁴⁾ | 306,670 | 10.8% |
| Matthew P. Smith ⁽⁵⁾ | 282,495 | 10.0% |
| Linda H. Smith ⁽⁶⁾ | 282,495 | 10.0% |
| James L. Green ⁽⁷⁾ | 199,431 | 7.0% |
| Mary Janet Green ⁽⁸⁾ | 199,431 | 7.0% |

(1)

The address of Delta International Holding Ltd. is Scotia Center, 4th Floor, P.O. Box 2804, George Town, Grand Cayman, Cayman Islands. The addresses for Mr. and Mrs. Smith and Mr. and Mrs. Green are c/o PECO II, Inc., 1376 State Route 598, Galion, OH 44833. The address for Austin W. Marx and David M. Greenhouse is 527 Madison Ave., Suite 2600, New York, NY 10022. The address of Skiritai Capital LLC is 388 Market Street, Suite 700, San Francisco, CA 94111.

(2)

Based on information provided in a Schedule 13D filed on April 7, 2006 by Delta International Holding Ltd., Delta Electronics, Inc. and Delta Products Corporation.

(3)

Edgar Filing: PECO II INC - Form DEF 14A

Based on information provided in a Schedule 13G/A filed on February 13, 2009, by Austin W. Marxe and David M Greenhouse, controlling principals of AWM Investment Company, Inc. (AWM), the general partner of and investment adviser to Special Situations Cayman Fund, L.P. AWM also serves as the general partner of MGP Advisers Limited Partnership, the general partner of and investment adviser to Special Situations Fund III, L.P., and the general partner of and investment adviser to Special Situations Fund QP, L.P. Marxe and Greenhouse share voting and investment power over 104,452 common shares owned by Special Situations Cayman Fund, L.P., 231,630 common shares owned by Special Situations Fund III QP, L.P. and 17,000 common shares owned by Special Situations Fund III, L.P.

(4)

Based on information provided in a Schedule 13G filed on April 23, 2008 by Skiritai Capital LLC (Skiritai), Leonidas Opportunity Fund L.P. (Leonidas Fund), Leonidas Opportunity Offshore Fund Ltd. (Leonidas Offshore Fund), Russell R. Silvestri (Silvestri), and Lyron L. Bentovim (Bentovim). Skiritai serves as the general partner of the Leonidas Fund and investment manager of the Leonidas Offshore Fund. Silvestri and Bentovim are Managing Directors of Skiritai.

(5)

Mr. Smith is a director of PECO II. Mr. Smith's ownership includes 132,495 shares held by Mr. Smith and his spouse, Linda H. Smith, as joint tenants, 100,000 common shares held by Ashwood I, LLC and 50,000 common shares held by Ashwood II, LLC. Mr. Smith has shared voting and dispositive power over the securities held by these limited liability companies.

(6)

Ms. Smith's ownership includes 132,495 common shares held by Ms. Smith and her spouse, Matthew P. Smith, as joint tenants, 100,000 common shares held by Ashwood I, LLC, and 50,000 common shares held by Ashwood II, LLC. Ms. Smith has shared voting and dispositive power over the securities held by these limited liability companies.

(7)

Mr. Green is a director of PECO II. Mr. Green's ownership includes 189,070 common shares held by The Green Family Trust and 10,361 held by The Green Charitable Trust, both over which he shares voting and dispositive power with his spouse, Mary Janet Green.

(8)

Ms. Green's ownership includes 189,070 common shares held by the Green Family Trust and 10,361 held by the Green Charitable Trust, both over which she shares voting and dispositive power with her spouse, James L. Green.

Ownership of Common Shares by Management

The following table shows information regarding beneficial ownership of our common shares as of February 1, 2009, by each director, each of the officers named in the Summary Compensation Table, and all directors and executive officers as a group.

| Name and Address of Beneficial Owner ⁽¹⁾ | Common Shares Beneficially Owned | Percent Owned |
|---|---|------------------|
| Guy Kevin Borders ⁽²⁾ | 37,000 | 1.3% |
| Jacque Boyer ⁽³⁾ | 22,000 | * |
| James L. Green ⁽⁴⁾ | 199,431 | 7.0% |
| John G. Heindel ⁽⁵⁾ | 115,281 | 4.0% |
| E. Richard Hottenroth ⁽⁶⁾ | 12,275 | * |
| Gerard B. Moersdorf, Jr. ⁽⁷⁾ | 2,000 | * |
| Richard W. Orchard ⁽⁸⁾ | 1,500 | * |
| R. Louis Schneeberger ⁽⁹⁾ | 1,750 | * |
| Matthew P. Smith ⁽¹⁰⁾ | 282,495 | 10.0% |
| Thomas R. Thomsen ⁽¹¹⁾ | 2,000 | * |
| All directors and executive officers as a group (10 persons) ⁽¹²⁾ | 675,732 | 23.0% |

*

Less than 1%.

(1)

The address of the directors and executive officers listed is c/o PECO II, Inc., 1376 State Route 598, Galion, OH 44833.

(2)

Mr. Borders is our Vice President of Marketing & Product Development and Secretary. Mr. Borders' s ownership includes 32,000 shares issuable within 60 days after February 1, 2009 upon the exercise of stock options.

(3)

Ms. Boyer is our Vice President of Sales and Sales Operations. Ms. Boyer' s ownership includes 22,000 shares issuable within 60 days after February 1, 2009 upon the exercise of stock options.

(4)

Mr. Green is a director of PECO II. Mr. Green's ownership includes 189,070 common shares held by The Green Family Trust and 10,361 shares held by The Green Charitable Trust over which he shares voting and dispositive power.

(5)

Mr. Heindel is our Chairman of the Board, President, Chief Executive Officer, Chief Financial Officer and Treasurer. Mr. Heindel's ownership includes 58,000 common shares issuable within 60 days after February 1, 2009 upon the exercise of stock options.

(6)

Mr. Hottenroth is a director of PECO II. Mr. Hottenroth's ownership does not include 6,500 common shares held by his spouse.

(7)

Mr. Moersdorf, Jr. is a director of PECO II.

(8)

Mr. Orchard is a director of PECO II.

(9)

Mr. Schneeberger is a director of PECO II.

(10)

Mr. Smith is a director of PECO II. Mr. Smith's ownership includes 132,495 shares held by Mr. Smith and his spouse as joint tenants, 100,000 common shares held by Ashwood I, LLC and 50,000 common shares held by Ashwood II, LLC. Mr. Smith has shared voting and dispositive power over the securities held by these limited liability companies.

(11)

Mr. Thomsen is a director of PECO II.

(12)

Ownership of all directors and executive officers as a group includes an aggregate of 112,000 common shares issuable within 60 days after February 1, 2009 upon the exercise of stock options.

ELECTION OF DIRECTORS

(Proposal No. 1)

The authorized number of our directors presently is fixed at nine. As required by our Amended and Restated Articles of Incorporation, the Board of Directors is divided into three classes of directors. The term of office of one class of directors expires each year, and at each annual meeting of shareholders the successors to the directors of the class whose term is expiring at that time are elected to hold office for a term of three years. There are currently three directors in each of Class I and Class III, and two directors in Class II. There is one vacancy in Class II.

The term of office of Class III of the Board of Directors expires at this year's annual meeting of shareholders. The term of office of the persons elected directors in Class III at this year's annual meeting will expire at the time of the annual meeting held in 2012. Each director in Class III will serve until the expiration of that term or until his or her successor shall have been duly elected. The Board of Director's nominees for election as Class III directors are James L. Green, Richard W. Orchard and Matthew P. Smith.

The proxy holders named in the accompanying proxy or their substitutes will vote the proxy at the annual meeting or any adjournment or postponement thereof for the election as directors of the three nominees unless the shareholder instructs, by marking the appropriate space on the proxy, that authority to vote is withheld. Each of the nominees has indicated his or her willingness to serve as a director, if elected. If any nominee should become unavailable for election (which contingency is not now contemplated or foreseen), it is intended that the shares represented by the proxy will be voted for such substitute nominee as may be named by the Board of Directors. In no event will the accompanying proxy be voted for more than three nominees or for persons other than those named below and any such substitute nominee for any of them.

Nominees for Election as Class III Directors Terms Expire in 2012

James L. Green, age 81 Director since 1988.

James L. Green was one of the founders of PECO II in 1988, served as Chairman of the Board of Directors until July 2001, served as Chief Executive Officer from 1988 to 1990 and April 2003 to June 2006, and as the President from 1989 to 1990 and April 2003 to June 2006. Mr. Green has over 50 years of experience in the communications industry. From 1983 to 1988, Mr. Green also worked as a management consultant in the international communications industry. From 1983 to 1985, Mr. Green was President and Chief Executive Officer of NovAtel Communications, Ltd. in Calgary, Canada. From 1953 to 1983, Mr. Green served in various capacities with the Power Equipment Company, North Electric Company and ITT, the predecessor businesses of PECO II, Inc.

Richard W. Orchard, age 55 Director since 2006.

Mr. Orchard is a retired telecommunications executive with over 25 years experience in sales, operations and general management. Mr. Orchard most recently served as Chief Transition Officer of Sprint Nextel Corporation in connection with the merger of Sprint and Nextel Communications, Inc. from December 2004 until late 2005. Prior to his role as Chief Transition Officer, Mr. Orchard served as Nextel's Senior Vice President and Chief Service Officer and prior to that as Eastern Regional President. Prior to joining Nextel, Mr. Orchard also served in various capacities for AirTouch and PacTel for ten years and Motorola Communications for five years. Mr. Orchard is also a director of Grande Communications Holdings, Inc., a company subject to the reporting requirements of Section 15(d) of the Securities Exchange Act of 1934.

Matthew P. Smith, age 55 Director since 1994.

Matthew P. Smith is self employed as a private investor in technology and energy companies. Mr. Smith served as the Chairman of the Board from July 2001 until July 2005. Mr. Smith was employed by PECO II in various capacities between 1989 and May 2004, including as Chief Executive Officer from 1998 to June 2002, and as our President from 1998 to July 2001. From 1996 to 1998, he served as Executive Vice President, from 1991 to 1998, he served as Secretary, and from 1990 to 1998 he served as Treasurer.

Class I Directors Continuing in Office Terms Expire in 2010

E. Richard Hottenroth, age 72 Director since 1997.

E. Richard Hottenroth has been a member of the firm Hottenroth, Garverick, Tilson & Garverick, Co., L.P.A. since 1961. Hottenroth, Garverick, Tilson & Garverick, Co., L.P.A. provides legal services to PECO II.

Gerard B. Moersdorf, Jr., age 57 Director since 2006.

Gerard B. Moersdorf, Jr. is the founder and innovator behind a start-up company called ACScout that has been highly successful from its inception in late 2006. He was also the founder of Applied Innovation Inc., which was acquired by Kentrox, Inc. in May 2007. Mr. Moersdorf served as Applied Innovation's Chairman of the Board from 1986 to May 2007, President, Chief Executive Officer, and Treasurer from 1986 to 2000 and as its President and Chief Executive Officer from August 2002 to January 2005.

R. Louis Schneeberger, age 54 Director since 2003.

Since January 2008, R. Louis Schneeberger has been a Partner and Managing Director of Knowledge Investment Partners, an alternative investment firm focused on the education sector with offices in Cleveland, New York, San Francisco and Geneva. From November 2005 to December 2007, R. Louis Schneeberger was an independent consultant who focused on assisting in several mergers and acquisitions and performing the Chief Financial Officer function for a Cleveland based large private company. From February 2004 to November 2005, Mr. Schneeberger served as Chief Financial Officer for OM Group, Inc, a \$1.3 billion international producer of metal-based specialty chemicals. Mr. Schneeberger is an experienced public-company executive with a background in public accounting and as a strategist, turnaround specialist, and business advisor. He was Chief Financial Officer and a director of Olympic Steel, Inc. (NASDAQ: ZEUS) from 1987 to 2000 and Chairman of the Board and audit committee of Royal Appliance Manufacturing Company (NYSE: RAM) from July 1995 to April 2003. He began his career with Arthur Andersen (1977 to 1987).

Class II Directors Continuing in Office Terms Expire in 2011

John G. Heindel, age 54 Director since 2005.

John G. Heindel became Chairman of the Board of Directors of our Company in June 2006, President and Chief Executive Officer of the Company in July 2005, and Chief Financial Officer and Treasurer in January 2008. Prior to his service with the Company, Mr. Heindel provided strategic consulting services since June 2003 to various companies interested in making acquisitions in the communications industry. Prior to his work as a consultant, Mr. Heindel spent more than 22 years with Lucent Technologies and its predecessor companies, most recently as the Company's President, Worldwide Services.

Thomas R. Thomsen, age 73 Director since 2003.

Thomas R. Thomsen is a veteran of more than 45 years in the telecommunications industry. His career includes 32 years with Western Electric/AT&T, where he held responsibilities for manufacturing, services, marketing, sales and administration at the senior executive level. After retiring from AT&T in 1990 he served as Chairman of the Board and CEO of Lithium Technology Corp., a publicly held development stage company, from August 1995 to November 1999. Mr. Thomsen currently serves on the board of EF Johnson Technologies, Inc., a company with a class of securities registered pursuant to the Securities Exchange Act of 1934, where he has been a director since July 1995, and the Executive Committee for the University of Nebraska Technology Park. Previously, he served on the boards of Western Electric, Sandia Corp, Olivetti Inc., AT&T Credit Corp., Lithium Technology Corp., and Rensselaer Polytechnic Institute.

The Board of Directors unanimously recommends a vote FOR the three nominees as Class III Directors whose three-year term will expire in 2012. Your proxy will be so voted unless you specify otherwise.

BOARD OF DIRECTORS AND CORPORATE GOVERNANCE MATTERS

The Board of Directors held seven meetings during the year ended December 31, 2008. During 2008, no director attended fewer than 75% of the aggregate of the total number of meetings of the Board of Directors, held during the period for which he or she has been a director, and the total number of meetings held by all Committees of the Board on which he or she served, during the periods that he or she served, except for Mr. Chang who attended two out of the five Board meetings held prior to his resignation on September 28, 2008.

The Board of Directors has determined that the following of its members are independent under the listing standards of the Nasdaq Stock Market: Messrs. Hottenroth, Orchard, Moersdorf, Jr., Schneeberger, and Thomsen.

Mr. Hottenroth is a partner in the law firm Hottenroth, Garverick, Tilson & Garverick, Co., L.P.A. Although Mr. Hottenroth's law firm provided legal services to PECO II in 2008 (and will continue to provide such services in 2009), the amount of legal fees paid to that firm in 2008 did not exceed the non-independence thresholds as set forth by the Nasdaq listing standards. The Board is aware of this relationship and determined that the payments made to Mr. Hottenroth's firm did not interfere with the exercise of his independent judgment as a director.

The independent directors intend to meet at least twice a year in executive sessions. Any independent director can request that an additional session be scheduled. The Company encourages each member of the Board of Directors to attend each annual meeting of shareholders. All of the Company's directors who were members of the Board at last year's annual meeting of shareholders held on May 6, 2008, were in attendance, except for Mr. Chang.

The Board of Directors maintains two standing committees: an Audit Committee and a Compensation/Nominating Committee. Set forth below is the current membership of each of the above-described committees:

| Compensation/Nominating Committee | Audit Committee |
|--|----------------------------|
| E. Richard Hottenroth | R. Louis Schneeberger |
| (Chairman) | (Chairman) |
| Richard W. Orchard | Gerard B. Moersdorf, Jr. |
| R. Louis Schneeberger | Richard W. Orchard |
| Thomas R. Thomsen | |

The Board has adopted a charter for the Audit Committee and a charter for the Compensation/Nominating Committee. The Board also adopted a Code of Conduct and Ethics that applies to all of PECO II's employees, officers and directors. These documents can be found on our website at www.peco2.com by clicking on the link for Investor Relations.

Audit Committee

The Audit Committee hires, oversees and reviews the activities of our independent registered public accounting firm and various company policies and practices. The specific functions and responsibilities of the Audit Committee are set forth in the Audit Committee Charter adopted by the Board of Directors. Our Board has determined that each of the members of the Audit Committee satisfies the current independence standards of the Nasdaq Stock Market listing standards and Section 10A(m)(3) of the Securities Exchange Act of 1934, as amended. The Audit Committee met four

times in 2008.

The Board also has determined that R. Louis Schneeberger is an audit committee financial expert as that term is defined in Item 407(d)(5)(ii) of Regulation S-K. As an audit committee financial expert, Mr. Schneeberger satisfies the Nasdaq financial literacy and sophistication requirements.

Compensation/Nominating Committee

The Compensation/Nominating Committee of the Board of Directors reviews executive compensation and administers the Company's stock option, incentive and employee stock purchase plans. The Compensation/Nominating Committee reviews and approves on an annual basis the corporate goals and objectives with respect to compensation for our Chief Executive Officer. In addition, the Compensation/Nominating Committee evaluates, at least once a year, our Chief Executive Officer's performance in light of these established goals and objectives and, based upon these evaluations, sets the Chief Executive Officer's compensation, including salary, bonus, incentive and equity compensation. Our Chief Executive Officer is not permitted to be present during voting or deliberations of his compensation. The Compensation/Nominating Committee also reviews and approves on an annual basis the evaluation and compensation structure for the Company's other executive officers, including approval of salary, bonus, incentive and equity compensation. Our Chief Executive Officer and, occasionally, our Human Resources Director are present and provide input at the meeting and deliberations on the compensation of the Company's other executive officers but are not permitted to be present at the vote.

The Compensation/Nominating Committee also recommends to the Company's full Board of Directors the compensation for non-employee Board members. For more information on the compensation aspects of the Compensation/Nominating Committee, please refer to Executive Compensation Compensation Discussion and Analysis The Compensation/Nominating Committee beginning on page 12 below.

The Compensation/Nominating Committee also considers and recommends to the Board of Directors nominees for election as directors and candidates to fill vacancies on the Board of Directors. Each member of the Compensation/Nominating Committee is independent in accordance with the applicable corporate governance listing standards of the Nasdaq Stock Market. The Compensation/Nominating Committee met five times in 2008.

Directors may be nominated by the Board of Directors or by shareholders in accordance with our Second Amended and Restated Code of Regulations. As a matter of course, the Compensation/Nominating Committee reviews the qualifications of various persons to determine whether they might make good candidates for consideration for membership on the Board of Directors. The Compensation/Nominating Committee will review all proposed nominees for the Board of Directors, including those proposed by shareholders, in accordance with its mandate contained in its charter and as described below. The Compensation/Nominating Committee will select qualified candidates and review its recommendations with the Board of Directors, which will decide whether to invite the candidate to be a nominee for election to the Board of Directors.

The Compensation/Nominating Committee does not rely on a fixed set of qualifications for director nominees. The Committee's primary mandate with respect to director nominees is to create a Board with a broad range of skills and attributes that is aligned with the Company's needs. The minimum qualifications for director nominees are that they:

.

be able to dedicate the time and resources sufficient for the diligent performance of the duties required by a member of the Board of Directors;

.

not hold positions that conflict with their responsibilities to the Company; and

.

comply with any other minimum qualifications for either individual directors or the Board as a whole mandated by applicable laws and regulations.

The Compensation/Nominating Committee's process for evaluating nominees for director, including persons recommended by shareholders, is to consider an individual's skills, independence, character, professional ethics, judgment, leadership experience, business experience, knowledge of issues facing publicly traded companies, and other relevant criteria as they may contribute to the Company's success. This evaluation is performed in light of the Committee's views as to the needs of the Board of Directors and the Company as well as what skill set and other characteristics would most complement those of the current directors. Ultimately, the Compensation/Nominating Committee will select prospective Board members who it believes will be effective, in conjunction with the other members of the Board, in collectively serving the long-term interests of our shareholders.

Edgar Filing: PECO II INC - Form DEF 14A

For a shareholder to submit a candidate for consideration by the Compensation/Nominating Committee for nomination for election as a director at the 2010 Annual Meeting, a shareholder must notify the Company's secretary between January 17, 2010 and February 16, 2010. Notices should be sent to: Corporate Secretary, 1376 State Route 598, Galion, Ohio 44833. The notice must contain, at a minimum, the following:

.
the name, age, business address and residence address of the proposed nominee;

.
the principal occupation or employment of the proposed nominee;

.
the number of shares of the Company which are beneficially owned by such candidate;

.
a description of all arrangements or understandings between the shareholder(s) making such nomination and each candidate and any other person or persons (naming such person or persons) pursuant to which nominations are to be made by the shareholder;

.
detailed biographical data and qualifications and information regarding any relationships between the candidate and the Company within the past three years;

.
any other information relating to the proposed nominee that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors pursuant to Section 14 of the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder;

.
any other information the shareholder believes is relevant concerning the proposed nominee;

.
a written consent of the proposed nominee(s) to be named as a nominee and to serve as a director if elected;

.
whether the proposed nominee is going to be nominated at the annual meeting of shareholders or is only being provided for consideration by the Compensation/Nominating Committee;

.
the name and record address of the shareholder who is submitting the notice;

the number of voting common shares which are owned of record or beneficially by the shareholder who is submitting the notice and the date such shares were acquired by the shareholder, and if such person is not a shareholder of record or if such shares are owned by an entity, reasonable evidence of such person's ownership of such shares or such person's authority to act on behalf of such entity; and

if the shareholder who is submitting the notice intends to nominate the proposed nominee at the annual meeting of shareholders, a representation that the shareholder intends to appear in person or by proxy at the annual meeting to nominate the proposed nominee named in the notice.

Compensation of Directors

In November 2007, each non-employee director was granted 1,000 restricted common shares (on a post-split basis) under the Company's Amended 2000 Performance Plan in lieu of an annual retainer for service from July 1, 2007 to June 30, 2008. In July 2008, each non-employee director was granted an annual cash retainer of \$10,000, payable on a quarterly basis, for service from July 1, 2008 to June 30, 2009. In addition to the annual cash retainer, each non-employee member of the Company's Board of Directors receives the following fees per meeting attended:

| Meeting Type | Fee Per Meeting |
|--------------------------------|------------------------|
| Board Meeting | \$1,000 |
| Committee Meeting | \$1,000 |
| Committee Meeting, Chairperson | \$1,500 |

Each board member is also entitled to reimbursement for all reasonable out-of-pocket expenses incurred in connection with his or her attendance at a board or committee meeting.

Employees and officers who are directors receive no additional compensation for services as directors. The Board of Directors, upon the recommendation of the Compensation/Nominating Committee, sets the compensation for non-employee directors. The table below shows the compensation earned by the Company's non-employee directors during 2008:

DIRECTOR COMPENSATION FOR 2008

| Name | Fees earned or paid in cash (\$) | Stock awards (\$)(1) | Option Awards (\$)(1) | All Other Compensation (\$) | Total (\$) |
|-----------------------------|--|----------------------------|-----------------------------|-----------------------------------|---------------|
| Albert Chang | | | | | |
| James L. Green | 12,000 | 6,347 | | | 18,347 |
| E. Richard Hottenroth | 32,500 | 6,347 | | | 38,847 |
| Gerard B. Moersdorf, Jr. | 20,000 | 6,347 | | | 26,347 |
| Richard W. Orchard | 24,000 | 6,347 | | | 30,347 |
| R. Louis Schneeberger | 39,500 | 6,347 | | | 45,847 |
| Matthew P. Smith | 11,000 | 6,347 | | | 17,347 |
| Thomas R. Thomsen | 30,000 | 6,347 | | | 36,347 |

(1)

Represents the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R, disregarding any estimate of forfeitures during the year, but accounting for any actual forfeitures by a director during the fiscal year. For a discussion of the assumptions made in the valuation of the dollar amount recognized, please refer to Footnote 15 of the Company's Financial Statements, which are set forth in Item 8 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Compensation Committee Interlocks and Insider Participation

No interlocking relationships exist between the Compensation/Nominating Committee and the Board of Directors or the compensation committee of any other company. The Chairman of the Compensation/Nominating Committee, E. Richard Hottenroth, is a partner in the law firm Hottenroth, Garverick, Tilson & Garverick, Co., L.P.A. Mr. Hottenroth's law firm provided legal services to us in 2008, and we expect that the firm will continue to provide such services in 2009.

Communications with the Board

In order to provide our shareholders and other interested parties a direct and open line of communication to the Board

of Directors, we have adopted the following procedures for communications with the Board.

Shareholders of the Company and other interested persons may communicate with the chairman of the Compensation/Nominating Committee or the Audit Committee or with the independent directors as a group by (i) sending such communication by regular mail or overnight delivery service to: Corporate Secretary, PECO II, Inc., P.O. Box 910, Galion, Ohio 44833 or (ii) sending an email to corporatesec@peco2.com. The mail or email should specify which of the foregoing is to be the intended recipient.

All communications received in accordance with these procedures will be reviewed initially by the Corporate Secretary of the Company, who will relay all such communications to the appropriate director or directors unless he or she determines that such communication:

.

does not relate to the business or affairs of the Company or the functioning or constitution of the Board of Directors or any of its committees; or

.

does not relate to significant matters that warrant the attention of the Board of Directors.

In alternative to the procedures outlined above, any shareholder or interested party may report any suspected accounting or financial misconduct confidentially through our whistleblower policy located on our website, www.peco2.com.

Executive Officers

The executive officers of the Company are elected annually by the Board of Directors and serve at the pleasure of the Board. In addition to John G. Heindel, President, Chief Executive Officer, Chief Financial Officer and Treasurer, the following persons are executive officers of the Company.

GUY KEVIN BORDERS, age 49, has served as Vice President of Marketing & Product Development since September 2005, and Secretary since January 2008. Prior to joining the Company, Mr. Borders was President of Omnova Consulting, Ltd., which provided business development and technical marketing services for telecom companies from 2002 to August 2005. Prior to his service at Omnova Consulting, Mr. Borders spent 15 years with Marconi/RELTEC in various leadership positions, including Vice President of North American Regional Marketing, Vice President of Strategic Sales and Marketing, and Vice President of Market Development.

JACQUIE BOYER, age 45, has served as Vice President of Sales since October 2006 and Vice President of Sales Operation since February 2008. Prior to joining the Company, Ms. Boyer held various positions with ADC, a leading telecommunications enterprise. From November 2005 to October 2006, she was Director of Sales, Americas Global OEM Accounts; from April 2004 to November 2005, she held the position of Director, Global Account Management; from November 2003 to April 2004, she was Director of Sales, National Accounts; from November 2002 to November 2003, she was Manager National Accounts; and from January 2001 to November 2002, she was National Channel Manager. Prior to joining ADC, Ms Boyer held a number of senior sales and business development positions in manufacturing organizations, and she has over 18 years sales and marketing experience.

EXECUTIVE COMPENSATION

The following information provides discussion, analysis and data tables regarding the compensation of our named executive officers (NEOs), who are those officers listed in our Summary Compensation Table on page 17. All references to specific amounts of equity compensation throughout this proxy statement reflect a 1-for-10 reverse stock split effective on May 7, 2008.

Compensation Discussion and Analysis

We have prepared this Compensation Discussion and Analysis (CD&A) to provide you with our perspective on executive compensation so that you may understand our compensation policies and our decisions regarding compensation for our NEOs. We recommend that you review the various executive compensation tables below in conjunction with this CD&A. Unless otherwise noted, the policies, plans and other information in this CD&A apply to all of our NEOs. Our CD&A covers the following topics:

.

the role of the Compensation/Nominating Committee in setting executive compensation;

.

our compensation philosophy and its underlying principles including the objectives of our executive compensation program and what it is designed to reward;

.

our process for setting executive compensation; and

.

the elements of our executive compensation program including a discussion of why we choose to pay each element of compensation, how we determine the amount of each element, and how each element fits into our overall compensation objectives and total compensation for our NEOs.

The Compensation/Nominating Committee

The Compensation/Nominating Committee (referred to in this CD&A as the Committee) was appointed by our Board of Directors and is governed by a written charter that is available in the corporate governance section of our website, www.peco2.com. The Committee members are Messrs. Hottenroth (Chairman), Orchard, Schneeberger, and Thomsen. Our Board of Directors has determined that each of the Committee members is independent under the standards of independence established by the Nasdaq Stock Market.

With the exception of E. Richard Hottenroth, the Committee is comprised solely of non-employee directors for purposes of Section 16(a) of the Securities and Exchange Act of 1934. Mr. Hottenroth is not considered a non-employee director under Section 16(a) of the Securities Exchange Act of 1934 because he is an attorney whose firm provides services to us. Accordingly, Mr. Hottenroth has abstained from voting when the Committee has considered approving stock option grants in order that such grants be exempt from the short-swing profit recapture provisions of Section 16(b) of the Securities Exchange Act of 1934.

Pursuant to its charter, the Committee has the authority and responsibility to:

·
discharge the Board's responsibilities relating to executive compensation, including the review and approval of our executive compensation philosophy and policies and the application of such policies to the compensation of our executive officers;

·
review and approve on an annual basis the corporate goals and objectives with respect to the Chief Executive Officer, evaluate the Chief Executive Officer's performance in light of such goals and objectives at least once a year, and, based on such evaluation, set the Chief Executive Officer's annual compensation, including salary, bonus, incentive and equity compensation;

·
review and approve on an annual basis the evaluation process and compensation structure for our other executive officers and to evaluate and approve the annual compensation for such executive officers, including salary, bonus, incentive and equity compensation;

·
administer and review our compensation programs and plans, including, but not limited to, our incentive compensation, equity, and qualified and non-qualified benefit plans;

establish and periodically review policies for the administration of our executive compensation program;

approve employment arrangements with new executives;

review recommendations to create, amend or terminate certain compensation and benefit plans and to make a decision whether or not to approve such recommendations; and

recommend to the Board the compensation arrangements with non-employee directors.

The Committee has the sole authority, to the extent it deems necessary or appropriate, to retain any compensation consultant to assist in the evaluation of executive compensation and has the sole authority to approve any such firm's fees. The Committee did not hire an outside consultant to assist in the evaluation of executive compensation for 2008. The Committee also has the authority to obtain advice and assistance from internal or external legal, accounting or other advisors, and may request any officer or employee of our Company, our outside counsel or registered independent public accounting firm to attend a meeting of the Committee or meet with any member, or consultants to, the Committee.

The Committee meets as often as its members deem necessary to discharge its duties and responsibilities and held five meetings during 2008. Mr. Hottenroth works in conjunction with our Chief Executive Officer to establish the meeting agenda. The Committee typically meets with the Chief Executive Officer and outside advisors and, where appropriate, other executive officers of our Company and our Human Resources Director. In addition, the Committee regularly meets in executive session without management. Generally, the Committee receives and reviews materials in advance of each meeting. These materials include information that management believes will be helpful to the Committee as well as materials that the Committee has specifically requested.

Compensation Philosophy and Objectives

The philosophy of the Committee is to make compensation decisions based on an executive compensation program that is designed to meet the following objectives:

to attract and retain qualified executives;

to reward, reinforce and provide incentives for individual performance and financial results; and

to align our NEOs' financial interests with our shareholders' financial interests.

As a result, we have designed our executive compensation program to attract and retain exceptional executives who seek a long-term association with us and who enjoy the challenge of pay for performance. Annual base salary increases, our non-equity incentive compensation plan, and equity compensation have been elements of our total compensation package that have been at-risk or variable depending on the performance of our NEOs.

We also use equity compensation awards to attract new key people, to recognize accomplishments under individually tailored business growth programs and to align the long-term interests of eligible executives with those of our shareholders. We believe that the grant of equity compensation is an effective means of linking NEO compensation and shareholder gains.

As part of our philosophy, we also believe that total compensation and accountability should generally increase with position and responsibility. Among our NEOs, individuals with a greater ability to impact the achievement of our performance goals bear a greater portion of the risk if goals are not achieved and reap a greater reward if goals are achieved.

Compensation Tax Philosophy

Section 162(m) of the Internal Revenue Code generally limits our ability to deduct compensation expenses in excess of \$1 million paid to any of our executive officers named in the Summary Compensation Table contained in this proxy statement. The Committee's policy with respect to Section 162(m) is to make every reasonable effort to ensure that compensation is deductible to the extent permitted, while simultaneously providing our executives with appropriate rewards for their performance. Towards this end, our Amended 2000 Performance Plan has been drafted in a manner that will qualify stock options and performance-related compensation not subject to the cap on

deductibility imposed by Section 162(m). We do not believe that the 162(m) limitations will impact the Company because the current level of compensation for each of PECO II's executive officers is well below the \$1 million salary limitation.

Committee Process for Determining Executive Compensation

A substantial amount of the Committee's annual cycle of work relates to the determination of compensation for our executive officers, including our Chief Executive Officer. Generally, in the first quarter of our fiscal year, the Committee makes determinations of base cash compensation, incentive compensation plan criteria and/or discretionary bonuses, if any, and equity grants for executive officers, including our Chief Executive Officer. For a discussion of each individual element of compensation and how it is specifically determined, you should refer to Compensation Program Elements beginning on page 14 below.

Although many compensation decisions are made in the first quarter of the fiscal year, our compensation planning process is not a rigid yearly process with fixed beginning and end points. Rather, compensation decisions are designed to promote our compensation philosophy and principles. The Committee believes that evaluation of executive performance, business and succession planning, and consideration of our business environment are year-round processes, and the Committee members monitor these as such.

Our Chief Executive Officer is not permitted to be present during voting or deliberations of his compensation. During this process, the Committee reviews and approves any new corporate goals and objectives with respect to compensation for our Chief Executive Officer. In light of the established goals and objectives, the Committee evaluates the performance of the Chief Executive Officer and, based upon these evaluations, sets the Chief Executive Officer's total compensation. The Committee also reviews and approves on an annual basis the evaluation and compensation structure for the Company's other executive officers, including approval of salary, bonus, incentive, and equity compensation. Our Chief Executive Officer and, occasionally, our Human Resource Director are present and provide input at the meeting and deliberations on the compensation of the Company's other executive officers but are not permitted to be present at the vote.

Compensation Program Elements

In 2008, each of our NEOs could have received one or more of the following elements of compensation:

.

salary;

.

non-equity incentive compensation;

.

equity compensation; and

.

health and welfare benefits.

The Committee carefully considered and chose each compensation program element as a critical component in a comprehensive total compensation package. Each element is intended to reward and motivate executives in different

ways consistent with our overall compensation principles and philosophy. Each of the elements has a critical relationship with one another with each focusing and rewarding different areas. These elements are necessary for us to achieve our compensation program objectives.

(1)

Salary:

Salary is also referred to as base compensation. Salary is the most fundamental of all our compensation program elements. Providing a competitive salary to our NEOs is essential to helping us attract and retain qualified executives.

Base salary for our NEOs is generally set annually taking into consideration our sales and profit growth, overall job performance and pay levels for executive officers of corporations of similar size and other considerations. The Committee utilizes, as a reference, up-to-date information on compensation practices of other companies from several independent sources. The Committee considers these factors subjectively in the aggregate. Because the Committee believes that each of these factors is significant and the relevance of each factor may vary depending on the duties and responsibilities of each executive officer, the Committee does not assign a formula weight to any single factor in determining a base salary increase. Instead, the Committee examines each factor in the context of individual and Company performance and business needs, internal pay equity where applicable, and incumbent pay history.

Mr. Heindel, our Chairman, President, Chief Executive Officer, Chief Financial Officer and Treasurer, joined the Company in July 2005 and, subject to his original employment agreement (the Original Employment Agreement), his initial annualized base salary was \$250,000 per year. Mr. Heindel's base salary was increased to \$260,000 by the Board, effective July 2006, and Mr. Heindel's annualized base salary is \$260,000 in his most recent employment agreement, dated January 29, 2008 (the New Employment Agreement). Mr. Heindel's base salary was considered to be at approximately the median base compensation level paid to chief executive officers of corporations of similar size and complexity to us.

In addition, the Company and Mr. Heindel agreed that Mr. Heindel be paid 50% of his base salary for the first nine months of calendar 2008 in restricted stock instead of cash. As a result, Mr. Heindel received 1,444 common shares on each of January 31, February 29, and March 31; 1,900 common shares on each of April 30, May 31, and June 30; 3,283 common shares on each of July 31 and August 31; and 3,282 common shares on September 30, 2008.

(2)

Bonus:

While the Company has granted discretionary bonuses in the past, there were no discretionary bonuses paid during 2008.

(3)

Non-Equity Incentive Compensation:

In an effort to build on our philosophy of pay-for-performance, the Committee established an annual non-equity incentive compensation plan, which in 2008 was called the 2008 Incentive Compensation Plan (the 2008 IC Plan). The goal of the 2008 IC Plan is to tie incentive compensation directly to the growth and profitability of our Company. The 2008 IC Plan pays cash awards to our employees based upon the achievement of both key company-wide performance goals and personal performance goals unique to the individual IC Plan participant.

For NEOs, 80% of the potential payout was tied to the achievement of company-wide performance goals, which were the achievement of revenue and EBITDA (earnings before interest, taxes, depreciation and amortization) targets. The revenue and EBITDA threshold targets must both be met before there are any payouts under the 2008 IC Plan, and each of these targets accounted for 50% of the company-wide performance goal portion of the 2008 IC Plan. The remaining 20% of the potential payout under the 2008 IC Plan was tied to the achievement of individual performance goals for each NEO.

Upon the achievement of the threshold revenue and EBITDA targets, our NEOs had the opportunity to receive threshold, target and maximum incentive compensation as follows:

| | Incentive Compensation Payout Opportunities for 2008 | | |
|-------------------|---|---------------|----------------|
| | Threshold | Target | Maximum |
| John G. Heindel | \$75,000 | \$150,000 | \$300,000 |
| Guy Kevin Borders | \$25,000 | \$ 50,000 | \$100,000 |
| Jacquie Boyer | \$42,500 | \$ 85,000 | \$170,000 |

In 2008, both the revenue and EBITDA targets were not met and, as a result, no payouts were made under the 2008 IC Plan.

In addition to the 2008 IC Plan, Ms. Boyer is also eligible to receive non-equity incentive compensation pursuant to a commission arrangement. In 2008, Ms. Boyer earned \$40,043 from commissions.

(4)

Equity Compensation:

We believe that emphasis on equity-based compensation opportunities encourages a high level of long-term performance that enhances shareholder value, thereby further linking leadership and shareholder objectives. Equity compensation also serves to attract and retain the best available individuals to serve as our NEOs. Equity compensation is intended to motivate our NEOs to contribute to our future growth and profitability and to reward their performance in a manner that:

.

provides them with a means to increase their holdings of the common stock of our Company;

.

encourages our NEOs to be long-term shareholders; and

.

aligns their interests with the interests of the shareholders of the Company.

Equity compensation is granted to our NEOs under our Amended 2000 Performance Plan (the Plan), which was approved (as amended) by our shareholders on April 24, 2004. The Committee determines the award opportunity level for each NEO based on the individual's responsibility level and potential within our Company, competitive practices, the number of shares available for grant, business needs, individual and Company performance, shareholder returns and the market price of our common stock. The Committee considers these factors subjectively in the aggregate. Because the Committee believes that each of these factors is significant, and the relevance of each factor may vary depending on the duties and responsibilities of each executive officer, the Committee does not assign a formula weight to any single factor in determining the amount of a grant. Instead, the Committee examines each factor in the context of individual and Company performance and business needs, internal pay equity where applicable, and incumbent pay history.

We have granted both stock options and restricted stock to our NEOs under the Plan. Under the Plan, stock options are granted at market price and typically vest 40% after the first year and 30% for second and third years. In 2008, we granted stock options covering 15,000 shares to each of Ms. Boyer and Mr. Borders, and stock options covering 20,000 shares to Mr. Heindel.

In 2008, we also granted Mr. Heindel \$40,000 of restricted stock based on fair market value on the date of grant, in lieu of any increase in his base compensation. In addition, as discussed above, Mr. Heindel agreed to take half of his salary in the form of restricted stock during the first nine months of 2008.

For more information on grants of stock options and restricted stock to NEOs, refer to the Summary Compensation Table and Grants of Plan-Based Awards Table below beginning on page 17.

(5)

All Other Compensation:

The all other compensation category in our Summary Compensation Table beginning on page 17 consists of the following:

.

employer-paid premiums for life insurance;

.

employer-paid car allowance; and

.

employment/severance agreements and change-in-control arrangements.

(a)

Employer-Paid Premiums for Life Insurance:

We provide each of our associates, including NEOs, with the option to purchase basic group term life insurance with a death benefit equal to two times their annual salary at a discounted premium. This element of compensation, though relatively inexpensive, provides one additional item to the overall compensation package which strengthens our ability to recruit and retain talented associates.

We also provide Mr. Heindel with an individual term life insurance policy in the amount of \$1,000,000, which policy shall be payable in the amount of \$500,000, together with a gross-up of premiums to the designated beneficiaries of Mr. Heindel and any balance to the Company, if Mr. Heindel shall become deceased at any time during the term of this agreement or extensions or renewals thereof as defined in said policy.

For specific premium amounts paid, please refer to the Summary Compensation Table s All Other Compensation column and footnotes below on page 17.

(b)

Employer-paid car allowance:

As part of our employment agreement with Mr. Heindel, we provide Mr. Heindel with a monthly car allowance. For specific premium amounts paid, please refer to the Summary Compensation Table s All Other Compensation column and footnotes below on page 17.

(c)

Employment/severance agreements and change-in-control arrangements:

In an effort to attract and retain the services of our NEOs, we have entered into an employment agreement with Mr. Heindel, our Chairman, President and Chief Executive Officer, and into letter agreements with Mr. Borders, our Vice President of Marketing and Product Development and Secretary and Ms. Boyer, our Vice President of Sales and Sales Operation. For a discussion of these agreements, please refer to Agreements with NEOs and Potential Payments upon Termination or Change in Control beginning on page 20 below.

(6)

Health and Welfare Benefits:

In addition to the compensation and benefits programs discussed in this document, we offer our employees, including our NEOs, a comprehensive benefits program. This program is designed to provide the employees and their families with competitive coverage at competitive rates. We strive to provide the employees with appropriate health benefits (medical, pharmacy, dental, and vision) to help protect the physical, mental and financial health of our employees and their immediate families.

Summary Compensation Table

The following table shows the compensation paid by PECO II, Inc. to each of the NEOs of the Company for the 2008, 2007 and 2006 fiscal years. For a discussion of the various elements of compensation provided in the table below, please refer to the discussion of our various compensation elements in our Compensation Discussion & Analysis under the heading "Compensation Program Elements" beginning on page 14 above.

SUMMARY COMPENSATION TABLE

| Name and Principal Position | Year | Salary | Bonus | Stock Awards | Option Awards | Non-Equity Incentive Plan Compen-sation | All Other Compen-sation | Total |
|--|------|---------|-------|-----------------|------------------|--|----------------------------|---------|
| | | (\$) | (\$) | (\$)(1) | (\$)(1) | (\$)(2) | (\$)(3) | (\$) |
| John G. Heindel Chairman of the Board, President, Chief Executive Officer, Chief Financial Officer and Treasurer | 2008 | 160,000 | | 136,170 | 29,337 | | 10,242 | 335,749 |
| | 2007 | 200,000 | | 105,000 | 36,795 | | 10,242 | 352,037 |
| | 2006 | 252,304 | | 122,537 | 76,525 | 100,000 | 10,242 | 561,608 |
| Guy Kevin Borders Vice President of Marketing & Product Development and Secretary | 2008 | 150,010 | | | 58,200 | | 240 | 208,450 |
| | 2007 | 150,010 | | | 31,619 | | 168 | 181,797 |
| | 2006 | 150,010 | 3,000 | 39,945 | 24,335 | | 196 | 217,486 |

Jacquie Boyer

| | | | | | | |
|---------------------------------|------|---------|--------|--------|-----|---------|
| Vice President | 2008 | 125,008 | 63,510 | 40,043 | 240 | 228,801 |
| of Sales and Sales Operation | 2007 | 125,008 | 40,024 | 26,905 | 168 | 192,105 |

(1)

Represents the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R, disregarding any estimate of forfeitures during the year, but accounting for any actual forfeitures by an NEO during the fiscal year. For a discussion of the assumptions made in the valuation of the dollar amount recognized, please refer to Footnote 15 to the Company's Financial Statements, which are set forth in Item 8 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

(2)

Represents the total of the performance-based incentive compensation earned, which is discussed in further detail under the heading "Executive Compensation Compensation Discussion and Analysis Non-Equity Incentive Compensation Plan" beginning on page 12 above.

(3)

Amounts include the following:

.

\$240 and \$168 of group term insurance premiums paid on behalf of Mr. Borders and Ms. Boyer in 2008 and 2007 and \$196 paid on behalf of Mr. Borders in 2006;

.

\$1,242 of executive life insurance premiums paid on behalf of Mr. Heindel in 2008, 2007 and 2006;

.

a \$750 monthly car allowance paid on behalf of Mr. Heindel in 2008, 2007 and 2006.

Grants of Plan-Based Awards Table

The following table provides certain information concerning each grant of an award made to the listed officers in the last completed fiscal year under any plan. For more information on the grants represented in this table, please refer to the discussions in our Compensation Discussion & Analysis under the headings Non-Equity Incentive Compensation Plan beginning on page 15 above and Equity Compensation beginning on page 15 above.

GRANT OF PLAN-BASED AWARDS TABLE FOR FISCAL 2008

| | Grant Date | Estimated Future Payouts Under Non-Equity Incentive Plan Awards | | | Estimated Future Payouts Under Equity Incentive Plan Awards | | | All Other Stock Awards: Number of Shares of Stock or Units (#) | All Other Awards: Number of Securities Underlying Options (#) | Exercise or Base Price of Option Awards (\$/Sh) |
|---------|------------|---|---------|---------|---|--------|---------|--|---|---|
| | | Threshold | Target | Maximum | Threshold | Target | Maximum | | | |
| | | (\$)(1) | (\$) | (\$) | (#) | (#) | (#) | | | |
| Indel | n/a | 75,000 | 150,000 | 300,000 | | | | | | |
| | 01/03/2008 | | | | | | | 20,000 | 7.50 | |
| | 01/03/2008 | | | | | | 4,332 | | | |
| | 01/29/2008 | | | | | | 5,797 | | | |
| | 04/01/2008 | | | | | | 5,700 | | | |
| | 07/01/2008 | | | | | | 9,848 | | | |
| Borders | n/a | 25,000 | 50,000 | 100,000 | | | | | | |
| | 01/03/2008 | | | | | | | 15,000 | 7.50 | |
| yer | n/a | 42,500 | 85,000 | 170,000 | | | | | | |
| | n/a | | | n/a(2) | | | | | | |
| | 01/03/2008 | | | | | | | 15,000 | 7.50 | |

(1)

If the threshold target is not met, the award is 0.

(2)

Under Ms. Boyer's 2008 commission plan, there was no cap on the maximum potential payout.

Outstanding Equity Awards at Fiscal Year-End Table

The following table provides information concerning unexercised options, stock that has not vested, and equity incentive plan awards outstanding as of the end of the last completed fiscal year:

OUTSTANDING EQUITY AWARDS AT FISCAL 2008 YEAR-END

| | Option Awards | | | | | Stock Awards | | |
|--------------|---|---|---|----------------------------|--|---|--|---|
| | Number of Securities Underlying Unexercised Options (#) | Number of Securities Underlying Unexercised Options (#) | Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#) | Option Exercise Price (\$) | Option Expiration Date | Number of Shares or Units of Stock That Have Not Vested (#) | Market Value of Shares or Units of Stock That Have Not Vested (\$) | Equity Incentive Plan Awards: Number of Unearned Shares, Units or Rights That Have Not Vested (#) |
| ne eindel | Exercisable 50,000 | Unexercisable 20,000(1) | | 10.70 7.50 | 07/28/2010 01/03/2013 | | | |
| a Borders | 25,000 700 | 300(2) 15,000(3) | | 12.00 19.60 7.50 | 08/31/2010 03/28/2011 01/03/2013 | | | |
| oyer | 14,000 2,000 | 6,000(4) 3,000(5) 15,000(3) | | 11.80 7.00 7.50 | 10/09/2011 09/21/2012 01/03/2013 | | | |

(1)

8,000 shares vested on January 3, 2009, 6,000 shares vest on January 3, 2010 and 6,000 shares vest on January 3, 2011.

(2)

300 shares vested on March 28, 2009.

(3)

6,000 shares vested on January 3, 2009, 4,500 shares vest on January 3, 2010 and 4,500 shares vest on January 3, 2011.

(4)

6,000 shares vest on October 9, 2009.

(5)

1,500 shares vest on September 21, 2009 and 1,500 shares vest on September 21, 2010.

Option Exercises and Stock Vested Table

The following table provides certain information concerning each exercise of stock options, and each vesting of stock, including restricted stock, during the last completed fiscal year:

OPTION EXERCISES AND STOCK VESTED FOR FISCAL 2008

| Name | Option Awards | | Stock Awards | |
|-------------------|---------------------------------------|----------------------------|---|---------------------------|
| | Number of Shares Acquired on Exercise | Value Realized on Exercise | Number of Shares on Acquired on Vesting | Value Realized on Vesting |
| | (#) | (\$) | (#) | \$(1) |
| John G. Heindel | | | 25,677 | 100,370 |
| Guy Kevin Borders | | | | |
| Jacquie Boyer | | | | |

(1)

Value realized was calculated based on the number of shares vested multiplied by the fair market value of a share of the Company's common stock on the date of vesting.

Agreements with NEOs and Potential Payments upon Termination or Change in Control

On July 28, 2005, the Company and Mr. Heindel entered into an employment agreement (the "Old Employment Agreement"). The Old Employment Agreement contains an initial term of two years, with automatic two-year renewal periods unless either party gives notice within 90 days of the expiration of the initial term or any subsequent two-year renewal term. Under the terms of the Old Employment Agreement, Mr. Heindel received an annualized base salary of \$250,000 per year and was eligible to receive an annualized bonus of up to \$250,000 per year based upon performance criteria set by the Company's Compensation/Nominating Committee, which for Mr. Heindel's first year of employment was based on the Company's achievement of sales, earnings and cash flow targets.

The Old Employment Agreement also provided for severance payments to Mr. Heindel in the event of termination of employment by the Company without cause, by Mr. Heindel with good reason, and following a change in control of the Company. Under the Old Employment Agreement, Mr. Heindel also agreed not to compete against the Company for a period of one year following any termination of Mr. Heindel's employment with the Company.

On January 29, 2008, the Company and Mr. Heindel entered into a new employment agreement (the "New Employment Agreement"). The New Employment Agreement has an initial term ending on December 31, 2009, and automatically renews for successive one-year periods, unless either party gives 90 days' prior written notice to the other party of its intent not to renew the New Employment Agreement. Mr. Heindel will receive an annual base salary of \$260,000, which will be reviewed and may be increased subject to the approval of the Compensation/Nominating Committee. In addition, pursuant to the terms of the New Employment Agreement, the Company has granted Mr. Heindel such number of shares of restricted stock under the Company's Amended 2000 Performance Plan, or any successor plan, equal to (i) \$40,000 divided by (ii) the closing price of our common stock on the date of grant, on each of January 29, 2008 and January 2, 2009. The January 29, 2008 grant of restricted stock vested on December 31, 2008 and the January 2, 2009 grant is scheduled to vest on December 31, 2009.

Under the New Employment Agreement, Mr. Heindel will be eligible to participate in any cash bonus plan which is established from time to time in an amount determined by the Committee, and Mr. Heindel is eligible for awards granted under the Company's Amended 2000 Performance Plan, at the discretion of the Committee. Mr. Heindel is entitled to a car allowance of \$750 per month during the term of the New Employment Agreement. The Company agreed to obtain a life insurance policy for a duration of not less than the term of the New Employment Agreement upon the life of Mr. Heindel in the amount of \$1,000,000, which policy shall be payable \$500,000 together with gross-up of premiums to the beneficiaries of Mr. Heindel and any balance to the Company.

In the event of a termination due to the death or Disability (as defined in the New Employment Agreement) of Mr. Heindel, Mr. Heindel's employment will be deemed terminated as of the end of the month in which such death occurs or Disability is determined, and the Company will pay to Mr. Heindel, or his beneficiary, base salary and benefits for a period of 90 days from the deemed termination date. In addition, Mr. Heindel's stock options will immediately vest 100% upon his death or Disability and may be exercised for 90 days from the deemed termination date.

In the event of a termination of Mr. Heindel for Cause (as defined in the New Employment Agreement), all obligations of the Company to Mr. Heindel shall cease.

If a change in control (as defined in the New Employment Agreement) occurs at any time during the term of the New Employment Agreement, and within six months of the date of the change in control either (i) Mr. Heindel terminates his employment for any reason or (ii) the Company terminates Mr. Heindel's employment for any reason other than for Cause, then Mr. Heindel is entitled to the following: 2.0 times the sum of (x) Mr. Heindel's annual salary in effect on the date of termination, (y) any accrued cash bonuses (which are accrued at the time of termination) and (z) the continuing payment of his family COBRA health insurance coverage for a maximum of 18 months from the date of termination. In addition, Mr. Heindel's stock options will immediately vest 100% and may be exercised for a period of

12 months from the termination date.

In the event of a termination without Cause upon not less than 90 days advance written notice under the New Employment Agreement, the Company will pay to Mr. Heindel: (i) base salary for an additional 12 months in accordance with normal payroll practices and (ii) an amount equal to any accrued cash bonuses (that are accrued at the time of termination) in a lump sum within three months after such termination. The Company may accelerate the effective date of the termination without Cause if the Company increases the amount payable to Mr. Heindel to an

amount equal to the amount Mr. Heindel would receive following termination within six months of a change in control, as described above. In addition, Mr. Heindel's stock options will immediately vest 100% upon termination and may be exercised for 90 days from the termination date.

In the event of a termination by Mr. Heindel without Good Reason (as defined in the New Employment Agreement) upon not less than 90 days' advance written notice to the Company, the Company shall pay to Mr. Heindel base salary and benefits for a period of 90 days from the date of such notice. In addition, Mr. Heindel's stock options may be exercised for 90 days from the termination date.

In the event of a termination by Mr. Heindel with Good Reason, the Company shall pay to Mr. Heindel an amount equal to the amount Mr. Heindel would receive following termination within six months of a change in control, as described above. In addition, Mr. Heindel's stock options will immediately vest 100% and may be exercised for 90 days from the termination date.

Notwithstanding the foregoing, if Mr. Heindel is a "specified employee" as defined in Internal Revenue Code Section 409A, Mr. Heindel is not entitled to any payments until the earlier of (1) the date that is six months after the date of termination or (2) the date of his death.

Under the New Employment Agreement, Mr. Heindel has also agreed not to compete against the Company for a period of one year following any termination of Mr. Heindel's employment with the Company.

The following table shows the potential payments upon termination or a change in control of the Company for Mr. Heindel. Where it is not possible to give a precise dollar amount for potential payments, estimates have been used. The estimates assume that the triggering event took place on December 31, 2008, the last day of the Company's prior fiscal year. For purposes of valuing the Company's common stock on December 31, 2008, we have used the Company's closing stock price of \$2.45 on December 31, 2008.

| Executive Benefits and Payments Upon Termination Compensation: | Termination by Mr. Heindel without Good Reason⁽¹⁾ | Termination by Company with Cause | Termination by Company without Cause | Termination by Mr. Heindel for Good Reason | Termination upon Death or Disability | Certain Terminations Involving a Change in Control under Executive Agreement |
|---|---|--|---|---|---|---|
| | (\$) | (\$) | (\$) | (\$) | (\$) | (\$) |
| Base Salary (Severance Payment) | | | 260,000(2) | 520,000(3) | 65,000(4) | 520,000(3) |
| Incentive Compensation (Accrued but Unpaid) | | | | | | |
| Incentive Compensation (Severance Payment) | | | | | | |

Stock Options
(Acceleration of
Vesting)

Restricted Stock
(Acceleration of
Vesting)

Benefits:

Relocation Benefits

Medical, Health
and Welfare

Benefits

Total value:

| | | | | |
|---------|---------|--------|---------|--------|
| | | 12,560 | 3,140 | 12,560 |
| 260,000 | 532,560 | 68,140 | 532,560 | |

(1)

Assumes Mr. Heindel provided notice to termination 90 days prior to December 31, 2008. Mr. Heindel would continue to receive salary and benefits during such 90-day period ending on December 31, 2008, unless the provisions of section 409A of the Internal Revenue Code require payment at a later date.

(2)

Payment over a 12-month period in accordance with normal payroll practices unless the provisions of section 409A of the Internal Revenue Code require payment at a later date. Upon Mr. Heindel accepting a full-time position with another employer, payments terminate.

(3)

Payable as soon as reasonably practicable, unless the provisions of section 409A of the Internal Revenue Code require payment at a later date.

(4)

Payment over a 90 day period unless the provisions of section 409A of the Internal Revenue Code require payment at a later date.

Agreements with Mr. Borders

On August 30, 2005, the Company and Mr. Borders entered into a letter agreement regarding Mr. Border s employment. Under the terms of his letter agreement, Mr. Borders receives an annualized base salary of \$150,000 per year. The letter agreement does not have a stated term and Mr. Border s employment is at will.

On May 23, 2007, the Company and Mr. Borders entered into an agreement, which provides for a severance payment to Mr. Borders in the event of Mr. Borders termination within 12 months of a change in control of the Company (or within six months of a change in control by Mr. Borders for good reason). Upon termination within 12 months following change in control of the Company (or within six months of a change in control by Mr. Borders for good reason), Mr. Borders will receive cash compensation equivalent to total cash compensation for the previous year, which was \$150,010 for 2008. In addition, any unvested stock options or restricted stock awards held by Mr. Borders would immediately vest. If Mr. Borders were terminated following a change in control as of December 31, 2008, such acceleration would not result in any additional benefit to Mr. Borders as all of his options were under water as of such date.

Agreement with Ms. Boyer

On September 28, 2006, the Company and Ms. Boyer entered into a letter agreement regarding Ms. Boyer s employment. Under the terms of her letter agreement, Ms. Boyer receives an annualized base salary of \$125,000. The letter agreement with Ms. Boyer also sets forth that her targeted bonus would be at \$85,000. The letter agreement does not have a stated term and Ms. Boyer s employment is at will.

On May 23, 2007, the Company and Ms. Boyer entered into an agreement, which provides for a severance payment to Ms. Boyer in the event of Ms. Boyer s termination within 12 months of a change in control in the Company (or within six months of a change in control by Ms. Boyer for good reason). Upon termination within 12 months following change in control of the Company (or within six months of a change in control by Ms. Boyer for good reason), Ms. Boyer will receive cash compensation equivalent to total cash compensation for the previous year, which was \$165,051 for 2008. In addition, any unvested stock options or restricted stock awards held by Ms. Boyer would immediately vest. If Ms. Boyer were terminated within 12 months following a change in control (or Ms. Boyer terminated her employment for good reason within six months following a change in control) as of December 31, 2008, such acceleration would not result in an additional benefit to Ms. Boyer as all of her options were under water as of such date.

Equity Compensation Plan Information

The following table sets forth information concerning common shares authorized or available for issuance under our equity compensation plans as of December 31, 2008.

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, | Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities |
|----------------------|--|--|---|
|----------------------|--|--|---|

| | Warrants and Rights | | Reflected in Column (a) |
|--|--------------------------------|---------------|--------------------------------|
| | (a) | (b) | (c) |
| Equity compensation plans approved by shareholders(1) | 237,402 | \$9.98 | 141,259 |
| Equity compensation plans not approved by shareholders | | | |
| Total | 237,402 | \$9.98 | 141,259 |

(1)

Equity compensation plans approved by shareholders include the Amended 2000 Performance Plan and the 2000 Employee Stock Purchase Plan.

COMPENSATION/NOMINATING COMMITTEE REPORT

The Compensation/Nominating Committee has reviewed and discussed the Compensation Discussion and Analysis contained in this proxy statement with management and based on that review and discussions, the Compensation/Nominating Committee has recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Company's annual report on Form 10-K for the year ended December 31, 2008, and this proxy statement for filing with the Securities and Exchange Commission.

COMPENSATION/NOMINATING COMMITTEE

E. RICHARD HOTTENROTH, CHAIRMAN

RICHARD W. ORCHARD

R. LOUIS SCHNEEBERGER

THOMAS R. THOMSEN

REVIEW AND APPROVAL OF TRANSACTIONS WITH RELATED PERSONS

It is the written policy of the Company that the Audit Committee will review the material facts of all related party transactions that require approval and either approve or disapprove of the entry into the related party transaction. A related party transaction is any transaction between the Company and any related party, other than (i) transactions available to all employees generally; (ii) transactions involving less than \$5,000 when aggregated with all similar transactions; (iii) compensation of executive officers or directors if required to be reported in the Company's proxy statement; or (iv) transactions where the related party's interest arises solely from the ownership of the Company's common stock, and all holders of the Company's common stock receive the same benefit on a pro rata basis.

A related party includes: (i) a senior officer or director of the Company; (ii) a shareholder owning in excess of five percent of the Company (or its controlled affiliates); (iii) an immediate family member of a senior officer or director; or (iv) an entity owned or controlled by the foregoing or an entity in which one of the foregoing has a substantial ownership interest or control of such entity.

The Company is party to a Supply Agreement, dated September 29, 2008, between the Company and Delta Electronics, Inc. ("Delta") which is a successor agreement to a previous supply agreement between the Company and Delta, and allows the Company to access Delta's substantial engineering capabilities and high-quality, cost-effective component manufacturing for its power systems. Delta is a related person as defined in the instructions to Item 404(a) of Regulation S-K because it is an affiliate of Delta International Holding Ltd., which beneficially owns more than 5% of our common stock. For the year ended December 31, 2008, the Company's transactions with Delta under the Supply Agreement and its predecessor included \$144 thousand in sales and \$9.042 million in purchases.

AUDIT COMMITTEE AND RELATED MATTERS

The following Report of the Audit Committee does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Company filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent the Company specifically incorporates this Report by reference therein.

Report of the Audit Committee

The Audit Committee oversees our financial reporting process on behalf of the Board of Directors. The Audit Committee's activities are governed by a written charter adopted by the Board of Directors, a copy of which is posted on our website at www.peco2.com.

Management has the primary responsibility for our financial statements and the reporting process, including the system of internal controls. The Company's independent registered public accounting firm, Battelle & Battelle LLP, audits the annual financial statements prepared by management and expresses an opinion on the conformity of those financial statements with accounting principles generally accepted in the United States. The Audit Committee monitors these processes.

In this context, the Audit Committee met and held discussions with management and Battelle & Battelle LLP. Management represented to the Audit Committee that our financial statements were prepared in accordance with accounting principles generally accepted in the United States, and the Audit Committee reviewed and discussed the audited financial statements with management and Battelle and Battelle LLP, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of specific judgments and the clarity of disclosures in the financial statements. The Audit Committee also discussed with Battelle & Battelle LLP such other matters as are required to be discussed with the Audit Committee by Statement on Auditing Standards No. 61 (*Communications with Audit Committees*), as amended by Statement on Auditing Standards No. 90 (*Audit Committee Communications*).

In addition, Battelle & Battelle LLP provided to the Audit Committee the written disclosures and letter required by the applicable requirements of the Public Company Accounting Oversight Board regarding the independent registered public accounting firm's communications with the Audit Committee concerning independence. The Audit Committee discussed with Battelle & Battelle LLP its independence from us and management and considered the compatibility of nonaudit services with Battelle & Battelle LLP's independence.

The Audit Committee discussed with our financial management and Battelle & Battelle LLP the overall scope and plans for the audit. The Audit Committee also met with Battelle & Battelle LLP, with and without management present, to discuss the results of the examinations, their evaluation of our internal controls and the overall quality of our financial reporting. In addition, the Audit Committee considered other areas of its oversight relating to the financial reporting process that it determined appropriate.

Based on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board of Directors has approved, that the audited financial statements be included in our Annual Report on Form 10-K for the year ended December 31, 2008 for filing with the Securities and Exchange Commission.

AUDIT COMMITTEE

R. LOUIS SCHNEEBERGER, CHAIRMAN

GERARD B. MOERSDORF, JR.

RICHARD W. ORCHARD

Independent Registered Public Accounting Firm

Our Audit Committee engaged Battelle & Battelle LLP (Battelle) as the Company's independent registered public accounting firm for 2008. Battelle has served as the Company's independent registered public accounting firm since 2005.

The fees billed by Battelle in 2008 and 2007 for the indicated services performed during 2008 and 2007 were as follows:

| | Fiscal Year 2008 | Fiscal Year 2007 |
|--------------------|-----------------------------|-----------------------------|
| Audit Fees | \$173,400 | \$174,700 |
| Audit-Related Fees | 10,500 | |
| Tax Fees | | |
| All Other Fees | | |
| Total | \$183,900 | \$174,700 |

Audit Fees for 2008 and 2007 were for professional services rendered for the audit of our annual consolidated financial statements and the review of our consolidated financial statements included in our Quarterly Reports on Form 10-Q.

Audit-Related Fees for 2008 were for professional services rendered for accounting and SEC consultation related to the audit of our annual consolidated financial statements and the review of our consolidated financial statements included in our Quarterly Reports on Form 10-Q.

Representatives of Battelle & Battelle LLP are expected to be present at the annual meeting and will have an opportunity to make a statement if they desire to do so. Such representatives will be available to respond to appropriate questions.

Pre-Approval of Policies and Procedures

The Audit Committee has adopted a policy that requires advance approval of all audit and non-audit services provided by our independent registered public accounting firm to the engagement of the independent registered public accounting firm with respect to such services. The Chairman of the Audit Committee has been delegated the authority by the Audit Committee to evaluate and pre-approve the engagement of the independent registered public accounting firm when the entire Audit Committee is unable to do so. The Chairman must report all such pre-approvals to the entire Audit Committee at the next committee meeting.

None of the services described above were approved by the Audit Committee under the *de minimus* exception to pre-approval provided in Securities and Exchange Commission rules.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers and directors and persons who own 10% or more of a registered class of our equity securities, to file reports of ownership and changes in ownership on Forms 3, 4 and 5 with the SEC. Executive officers, directors and 10% or greater shareholders are required by SEC

regulations to furnish us with copies of all Forms 3, 4 and 5 they file.

Based solely on our review of the copies of such forms we have received, we believe that all of our executive officers and directors complied with all filing requirements applicable to them.

SHAREHOLDER PROPOSALS

Any shareholder proposal to be considered by us for inclusion in the proxy statement and form of proxy for the 2010 annual meeting, expected to be held in May 2010, must be received by our Secretary at our corporate headquarters, 1376 State Route 598, Galion, Ohio 44833, no later than December 18, 2009.

Shareholder proposals not intended to be included in the proxy statement and form of proxy for the 2010 annual meeting, as well as proposed shareholder nominations for the election of directors at the 2010 annual meeting must each comply with advance notice procedures set forth in our Second Amended and Restated Code of Regulations to be properly brought before the 2010 annual meeting. In general, written notice of a shareholder

proposal or a director nomination not to be included in the proxy statement and form of proxy must be delivered to our Secretary not less than 60 days nor more than 90 days prior to the first anniversary of the date on which the company first mailed our proxy materials for the prior year's annual meeting. With regard to the 2010 Annual Meeting of Shareholders, written notice must be received by our Secretary at the address above between January 17, 2010 and February 16, 2010. If we do not receive the notice between these dates, the notice will be considered untimely.

In addition to timing requirements, the advance notice provisions of our Second Amended and Restated Code of Regulations contain informational content requirements that also must be met. A copy of our Second Amended and Restated Code of Regulations may be obtained by writing to our Secretary at the address below.

OTHER MATTERS

Our Board of Directors is not aware of any matter to come before the meeting other than those mentioned in the accompanying notice. If other matters shall properly come before the meeting, however, it is the intention of the persons named in the accompanying proxy to vote in accordance with their best judgment on such matters.

Upon the receipt of a written request from any shareholder entitled to vote at the forthcoming annual meeting, we will mail, at no charge to the shareholder, a copy of our Annual Report on Form 10-K, including the financial statements and schedules required to be filed with the SEC pursuant to Rule 13a-1 under the Securities Exchange Act of 1934 for our most recent fiscal year. Requests from beneficial owners of our voting securities must set forth a good-faith representation that as of the record date for the annual meeting, the person making the request was the beneficial owner of securities entitled to vote at such annual meeting. Written requests for the Annual Report on Form 10-K should be directed to:

*Guy Kevin Borders
Vice President of Marketing & Product
Development and Secretary
PECO II, Inc.
1376 State Route 598
Galion, Ohio 44833*

You are urged to sign and return your proxy promptly in order to make certain your shares will be voted at the annual meeting. For your convenience a return envelope is enclosed requiring no additional postage if mailed in the United States.

By Order of the Board of Directors,

GUY KEVIN BORDERS
*Vice President of Marketing & Product
Development and Secretary*

April 17, 2009

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF
DIRECTORS**

ANNUAL MEETING OF SHAREHOLDERS MAY 19, 2009

**ISSUER SERVICES PROXY
DEPT.**

201 Shannon Oaks Circle

Suite 105

Cary, NC 27511-5570

CONTROL ID:

PROXY ID:

PASSWORD:

The undersigned hereby (i) appoints E. Richard Hottenroth and James L. Green, and each of them acting alone, as proxy holders and attorneys, with full power of substitution to each, to appear and vote all of the Common Shares of PECO II, Inc., which the undersigned shall be entitled to vote at the Annual Meeting of Shareholders of the Company, to be held at St. Joseph's Activity Center, 135 North Liberty Street, Galion, Ohio, on May 19, 2009, at 9:00 a.m., local time, and at any adjournments or postponements thereof, hereby revoking any and all proxies heretofore given, and (ii) authorizes and directs said proxy holders to vote all of the Common Shares of the Company represented by this proxy as indicated on the reverse side.

(CONTINUED AND TO BE SIGNED ON REVERSE SIDE.)

VOTING INSTRUCTIONS

Vote 24 hours a day, 7 days a week.

If you vote by fax, please DO NOT mail your proxy card.

MAIL: Please mark, sign, date, and return this Proxy Card promptly using the enclosed envelope.

FAX: Complete the reverse portion of this Proxy Card and Fax to **202-521-3464.**

INTERNET: <https://www.iproxydirect.com>

PHONE: 1-866-752-VOTE

**ANNUAL MEETING OF THE
SHAREHOLDERS OF**

**PLEASE COMPLETE, DATE, SIGN AND RETURN
PROMPTLY IN THE ENCLOSED ENVELOPE. PLEASE
MARK YOUR VOTE IN BLUE OR BLACK INK AS
SHOWN HERE: x**

PROXY SOLICITED ON BEHALF OF THE BOARD OF
DIRECTORS

**PECO II s Board of Directors
recommends a vote FOR
all Nominees listed below.**

Proposal 1

à

FOR ALL AGAINST ALL FOR ALL EXCEPT

E L E C T I O N O F
D I R E C T O R S .

o

o

James L. Green

o

**CONTROL
ID:**

Richard W. Orchard

o

PROXY ID:

Matthew P. Smith

o

PASSWORD:

Proposal 2

In their discretion, to
transact any other
business that may
properly come before the
annual meeting or any
adjournment or
postponement thereof.

**MARK "X" HERE IF YOU PLAN TO ATTEND
THE MEETING: o**

YOUR VOTE IS IMPORTANT

MARK HERE FOR ADDRESS CHANGE

New Address (if applicable):

If you do not vote by Telephone, Fax or Internet, please sign and date this proxy card and return it promptly in the enclosed postage-paid envelope, or otherwise to **ISSUER SERVICES PROXY DEPT., 201 Shannon Oaks Circle, Suite 105, Cary, NC 27511-5570**, so that your shares may be represented at the Annual Meeting. If you vote by Telephone, Fax or Internet, it is not necessary to return this proxy card.

IMPORTANT: Please sign exactly as your name or names appear on this Proxy. When shares are held jointly, each holder should sign. When signing as executor, administrator, attorney, trustee or guardian, please give full title as such. If the signer

is a corporation, please sign full corporate name by duly authorized officer, giving full title as such. If signer is a partnership, please sign in partnership name by authorized person.

THIS PROXY, WHEN EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED SHAREHOLDER. IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED FOR THE ELECTION OF ALL NOMINEES LISTED BELOW.

Dated: _____, 2009

(Print Name of Stockholder and/or Joint Tenant)

PLEASE COMPLETE, DATE, SIGN AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE. PLEASE MARK YOUR VOTE IN BLUE OR BLACK INK AS SHOWN HERE: x

(Signature of Stockholder)

(Second Signature if held jointly)