

PECO II INC
Form DEF 14A
March 18, 2002

SCHEDULE 14A INFORMATION

**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)

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**

March 22, 2002

To PECO II Shareholders:

This year's Annual Meeting of Shareholders of PECO II, Inc. will be held at 9:00 a.m., local time, Thursday, April 25, 2002, at St. Joseph's Activity Center, 135 North Liberty Street, Galion, Ohio.

In addition to discussing the items of business outlined in this proxy statement, we look forward to giving you a progress report on the first quarter of our current fiscal year, which will end on March 31. 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,

MATTHEW
P.
SMITH
*Chairman
and Chief
Executive
Officer*

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 Thursday, April 25, 2002 at 9:00 a.m. local time, for the following purposes:

1. To elect three directors in Class II 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 March 11, 2002 are entitled to receive notice of and to vote at the annual meeting.

By Order of
the Board
of
Directors.

SANDRA A.
FRANKHOUSE
Secretary

March 22, 2002

**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 March 22, 2002

Annual Meeting of Shareholders to be held on April 25, 2002

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 April 25, 2002, 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 II listed on the proxy.

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, in open 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, telegraph 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 March 11, 2002. On that date, we had 21,884,761 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 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 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 amended and restated code of regulations, all other questions and matters brought before the annual meeting will be decided, unless otherwise provided by law, by our amended and restated articles of incorporation or by our 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 other 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.

SHARE OWNERSHIP OF PRINCIPAL HOLDERS AND MANAGEMENT

The following table shows information regarding beneficial ownership of our common shares as of February 1, 2002, unless otherwise indicated, by each person or group which is known by us to own beneficially more than 5% of our common shares, each director and nominee for election as a director, each of the officers named in the Summary Compensation Table and all directors and executive officers as a group. All information with respect to beneficial ownership has been furnished by the respective director, officer or shareholder, as the case may be. Unless otherwise indicated, each person named below has sole voting power and investment power or shares this power with his or her spouse with respect to the number of shares set forth opposite his or her respective name. The address of each director and executive officer named below is c/o PECO II, Inc., 1376 State Route 598, Galion, Ohio 44833.

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 and any shares as to which the individual or entity has the right to acquire beneficial ownership within 60 days after February 1, 2002 through the exercise of any stock option or other right.

| Name of Beneficial Owner | Common Shares Beneficially Owned | Percent Owned |
|--|---|------------------|
| Matthew P. Smith(1) | 3,222,427 | 14.7% |
| James L. Green(2) | 2,378,536 | 10.9 |
| Lucille Garber Ford(3) | 2,191 | * |
| E. Richard Hottenroth(4) | 171,941 | * |
| Trygve A. Ivesdal(5) | 23,335 | * |
| Eugene V. Smith(6) | 582,766 | 2.7 |
| Charles D. Taylor(7) | 629,941 | 2.9 |
| Allen Jay Cizner(8) | 352,000 | 1.6 |
| John C. Maag(9) | 116,780 | * |
| Randolph C. Lumb(10) | 18,410 | * |
| All directors and executive officers as a group (11 persons)(11) | 7,629,332 | 34.1 |

* Less than 1%.

- (1) Mr. Smith is our Chairman of the Board and Chief Executive Officer. Mr. Smith's ownership includes 1,000,000 shares held by Ashwood I, LLC and 500,000 shares held by Ashwood II, LLC. Mr. Smith exercises investment control over both of these limited liability companies. Mr. Smith's ownership also includes 114,000 shares held by Mr. Smith or his wife, Linda Smith, as custodian for their three children. Mr. Smith's ownership also includes 7,227 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.

- (2) Mr. Green is a director of PECO II and former Chairman of the Board. Mr. Green's ownership includes 2,374,200 shares held by the Green Family Trust. Mr. Green exercises investment control over this trust. Mr. Green's ownership also includes 4,336 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (3) Dr. Ford is a director of PECO II. Dr. Ford's ownership includes 191 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (4) Mr. Hottenroth is a director of PECO II. Mr. Hottenroth's ownership includes 1,691 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (5) Mr. Ivesdal is a director of PECO II. Mr. Ivesdal's ownership includes 21,404 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (6) Mr. Smith is a director of PECO II. Mr. Smith's ownership includes 172,400 shares held by Fairbrandt, LLC. Mr. Smith exercises investment control over this limited liability company. Mr. Smith's ownership also includes 1,691 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (7) Mr. Taylor is a director of PECO II. Mr. Taylor's ownership includes 1,691 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (8) Mr. Cizner is our President and Chief Operating Officer. Mr. Cizner's ownership includes 350,000 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (9) Mr. Maag is our Chief Financial Officer. Mr. Maag's ownership includes 85,000 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (10) Mr. Lumb is our Executive Vice President of Sales and Marketing. Mr. Lumb's ownership includes 17,910 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.
- (11) Ownership of all directors and executive officers as a group includes an aggregate of 495,477 shares issuable within 60 days after February 1, 2002 upon the exercise of stock options.

ELECTION OF DIRECTORS

The authorized number of our directors presently is fixed at eight. As required by our amended and restated articles of incorporation, the Board of Directors is divided into two classes of three directors each and one class of two directors. One directorship in Class I is vacant at this time, which the Board of Directors has the authority to fill. As of the date of this proxy statement, the vacancy has not yet been filled. The Board of Directors will fill the vacancy when an individual whose services would be beneficial to us and our shareholders can be identified. 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.

The term of office of Class II 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 II at this year's annual meeting will expire at the time of the annual meeting held in 2005. Each director in Class II will serve until the expiration of that term or until his or her successor shall have been duly elected. The Board of Directors' nominees for election as directors in Class II are Lucille Garber Ford, E. Richard Hottenroth and Charles D. Taylor. Dr. Ford and Messrs. Hottenroth and Taylor currently serve as directors in Class II.

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 II Directors

Lucille Garber Ford, age 79 Director since 2000.

Since 1995, Lucille Garber Ford has served as President of the Ashland County Community Foundation and has been Professor Emerita of Economics and Provost of Ashland University. From 1970 to 1995, Dr. Ford has been a Professor of Economics at Ashland University.

E. Richard Hottenroth, age 65 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.

Charles D. Taylor, age 57 Director since 1989.

Since 2000, Charles D. Taylor has been a self-employed consultant. From 1991 to 2000, Mr. Taylor served as Vice President of DAI Emulsions Inc., a commercial coatings company.

Class III Directors Continuing in Office Terms Expires in 2003

James L. Green, age 74 Director since 1988.

James L. Green founded PECO II in 1988, and served as our Chairman of the Board of Directors until July 2001. 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.

Matthew P. Smith, age 48 Director since 1994.

Matthew P. Smith has been employed by PECO II since 1989, and in July 2001 Mr. Smith was appointed Chairman of the Board and continues as Chief Executive Officer. He served as our President and Chief Executive Officer since 1998. From 1996 to 1998, he served as Secretary, Treasurer and Executive Vice President. From 1991 to 1998, he served as Secretary and Treasurer and from 1990 to 1998, Mr. Smith served as Treasurer.

Class I Directors Continuing in Office Terms Expire in 2004

Trygve A. Ivesdal, age 71 Director since 2000.

Since August 2000 Trygve A. Ivesdal has been employed by PECO II as Director of International Development. From 1998 until October 2000, Mr. Ivesdal served as the Chairman of the Board of Directors of International Telecommunications Systems, Inc., a provider of satellite voice and data services in Latin America. From 1996 to 1998, Mr. Ivesdal served as Director of International Telecommunications Systems after co-founding the company in 1996. From 1993 to 1999, Mr. Ivesdal was the Executive Vice President, Interim Chief Operating Officer and Director of International Business Development for DIAL Services Ltd., an international calling card company and a subsidiary of Conference-Call USA, Inc.

Eugene V. Smith, age 78 Director since 1989.

Since 1985, Eugene V. Smith has been the general partner of Shelby Horizons Ltd., a partnership involved in warehousing. Since 1981, Mr. Smith has served as Vice President of FVF, Inc., an agri-business. Mr. Smith is the father of Matthew P. Smith, our Chairman and Chief Executive Officer.

BOARD OF DIRECTORS MEETINGS AND COMMITTEES

The Board of Directors has a Compensation Committee and an Audit Committee. The Compensation Committee administers our stock option plans and employee stock purchase plan and reviews and determines the salary and bonus compensation of our executive officers and certain key executives. The Audit Committee reviews the activities of our independent auditors 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. Each of the members of the Audit Committee satisfies the independence and financial literacy requirements of the Nasdaq National Market. The Board of Directors does not have a nominating committee.

Set forth below is the current membership of each of the above-described committees, with the number of meetings held during the fiscal year ended December 31, 2001 in parentheses:

| <u>Compensation Committee(5)</u> | <u>Audit Committee(4)</u> |
|-------------------------------------|-------------------------------------|
| E. Richard Hottenroth (Chairman) | E. Richard Hottenroth (Chairman) |
| Lucille Garber Ford | Lucille Garber Ford |
| Charles D. Taylor | Charles D. Taylor |

The Board of Directors held nine (9) meetings during the fiscal year ended December 31, 2001. During that fiscal year, 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.

Directors who are not our employees are paid an annual fee of \$10,000 and a fee of \$1,000 for each Board or Committee meeting attended and are entitled to reimbursement for all reasonable out-of-pocket expenses incurred in connection with their attendance at those meetings. In addition, directors are eligible for awards under the PECO II, Inc. 2000 Performance Plan. A discussion of other compensation arrangements with certain members of the Board of Directors is included in this proxy statement under the heading Certain Relationships and Related Transactions.

Compensation Committee Interlocks and Insider Participation

No interlocking relationships exist between the Compensation Committee and the Board of Directors or the compensation committee of any other company.

AUDIT COMMITTEE AND RELATED MATTERS

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.

Management has the primary responsibility for our financial statements and the reporting process, including the system of internal controls. The independent auditors audit the annual financial statements prepared by management and express 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 the independent auditors. 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 the independent auditors, 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 the independent auditors such other matters as are required to be discussed with the Audit Committee under generally accepted auditing standards.

In addition, the independent auditors provided to the Audit Committee the written disclosures and letter required by Independence Standards Board Standard No. 1 (Independence Discussions With Audit Committees), related to the auditors' independence. The Audit Committee discussed with the independent auditors the auditors' independence from us and management and considered the compatibility of nonaudit services with the auditors' independence.

The Audit Committee discussed with our financial management and independent auditors the overall scope and plans for the audit. The Audit Committee also met with the independent auditors, 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, 2001 for filing with the Securities and Exchange Commission.

AUDIT COMMITTEE

E. RICHARD HOTTENROTH, CHAIRMAN
LUCILLE GARBER FORD
CHARLES D. TAYLOR

Independent Auditors

Arthur Andersen LLP acted as our independent auditors for the fiscal year ended December 31, 2001.

Audit Fees

The aggregate fees billed or accrued by Arthur Andersen LLP for professional services rendered for the audit of our annual consolidated financial statements for fiscal 2001 and the review of our consolidated financial statements included in our quarterly reports on Form 10-Q for fiscal 2001 were \$148,000.

Financial Information Systems Design and Implementation Fees

There were no fees billed by Arthur Andersen LLP for services rendered in connection with financial information systems design and implementation in fiscal 2001.

All Other Fees

The aggregate fees billed by Arthur Andersen LLP for all other services rendered for fiscal 2001 were \$351,100.

Representatives of Arthur Andersen LLP are expected to be present at the annual meeting. They will have the opportunity to make a statement if they so desire and are expected to be available to respond to appropriate questions.

EXECUTIVE COMPENSATION

The following table shows the compensation during our fiscal years ended December 31, 2001, 2000 and 1999 of those persons who were, at December 31, 2001, our Chief Executive Officer and our other most highly compensated executive officers whose total salary and bonus (as determined in accordance with SEC rules) exceeded \$100,000. We refer to these executive officers as our named executive officers in other parts of this proxy statement.

Summary Compensation Table

| Name and Principal Position | Annual Compensation(1) | | | Long-Term Compensation Awards |
|--|------------------------|------------|------------|----------------------------------|
| | Year | Salary | Bonus | Securities Underlying Options(#) |
| Matthew P. Smith Chairman and Chief Executive Officer | 2001 | \$ 218,077 | | 75,000 |
| | 2000 | \$ 200,192 | \$ 146,757 | 1,907 |
| | 1999 | \$ 97,308 | \$ 110,333 | 10,000 |
| Allen Jay Cizner President and Chief Operating Officer(2) (3) | 2001 | \$ 210,560 | \$ 50,000 | 65,000 |
| | 2000 | \$ 192,308 | \$ 117,406 | 500,000 |
| | 1999 | | | |
| John C. Maag Chief Financial Officer(2)(4) | 2001 | \$ 160,000 | \$ 40,000 | 50,000 |
| | 2000 | \$ 138,462 | \$ 102,730 | 150,000 |
| | 1999 | | | |
| Randolph C. Lumb Executive Vice President Sales and Marketing(2)(5) | 2001 | \$ 150,000 | \$ 35,000 | |
| | 2000 | \$ 5,769 | | 44,776 |
| | 1999 | | | |

(1) In addition to the compensation set forth above, our Chief Executive Officer and each of our named executive officers also received compensation in an amount not exceeding \$500 in the form of insurance premiums paid by us in connection with term life insurance policies.

(2) Messrs. Cizner, Maag and Lumb received cash bonuses in accordance with their offers of employment.

(3) Mr. Cizner's employment with PECO II commenced in January 2000.

(4) Mr. Maag's employment with PECO II commenced in February 2000.

(5) Mr. Lumb's employment with PECO II commenced in December 2000.

2001 Option Grants

The following table shows grants of options to purchase our common shares to the named executive officers during our fiscal year ended December 31, 2001.

| Name | Individual Grants | | | | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(2) | |
|------------------|--|---|--------------------------------|-----------------|---|------------|
| | No. of Securities Underlying Options Granted (#) | % of Total Options Granted to Employees in Fiscal Year(1) | Exercise or Base Price (\$/Sh) | Expiration Date | 5%(\$) | 10%(\$) |
| Matthew P. Smith | 75,000 | 19.6% | \$ 6.37 | July 17, 2006 | \$ 132,000 | \$ 291,750 |
| Allen Jay Cizner | 65,000 | 16.9 | 6.37 | July 17, 2006 | 114,400 | 252,850 |
| John C. Maag | 50,000 | 13.0 | 6.37 | July 17, 2006 | 88,000 | 194,500 |
| Randolph C. Lumb | 0 | | 0 | | 0 | 0 |

* Less than 1%.

- (1) Based on an aggregate of 383,602 options we granted in 2001. The options granted to Mr. Smith, Mr. Cizner and Mr. Maag were granted under our 2000 Performance Plan. The options have a term of five years and vest 40% on the first anniversary following the date of grant, an additional 30% on the second anniversary and the remaining 30% on the third anniversary.
- (2) The potential realizable value represents amounts, net of exercise price before taxes that may be realized upon exercise of the options immediately prior to the expiration of their terms assuming appreciation of 5% and 10% over the option term. Assuming 5% and 10% annual appreciation, these values are calculated based on rules promulgated by the SEC and do not reflect our estimate of future stock price growth. The actual value realized may be greater or less than the potential realizable value set forth in the table.

2001 Option Values

The following table shows the value realized upon exercise of options during 2001 and the number and value of unexercised options held by each named executive officer at December 31, 2001.

| | Number of Shares Acquired on Exercise (#) | Value Realized (\$) | Number of Securities Underlying Unexercised Options at FY-End(#) | | Value of Unexercised In-the-Money Options at FY-End(\$)(1)(2) | |
|------------------|---|---------------------|--|---------------|---|---------------|
| | | | Exercisable(1) | Unexercisable | Exercisable | Unexercisable |
| Matthew P. Smith | 0 | 0 | 7,227 | 79,430 | \$ 23,580 | \$ 9,480 |
| Allen Jay Cizner | 0 | 0 | 200,000 | 365,000 | 0 | 0 |
| John C. Maag | 20,000 | 0 | 40,000 | 140,000 | 0 | 0 |
| Randolph C. Lumb | 0 | 0 | 17,911 | 26,865 | 0 | 0 |

- (1) Options are in-the-money if the fair market value of the common shares is greater than the exercise price.

- (2) Represents the total gain which would be realized if all in-the-money options beneficially held at December 31, 2001 were exercised, determined by multiplying the number of shares underlying the options by the difference between the per share option exercise price and the last sales price of the common shares of \$5.96 on the Nasdaq National Market on December 31, 2001.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

One of our directors, E. Richard Hottenroth, is a partner in the law firm Hottenroth, Garverick, Tilson & Garverick, Co., L.P.A. Hottenroth, Garverick, Tilson & Garverick, Co., L.P.A. provided legal services to us in 2001, and we expect that the firm will continue to provide such services in 2002.

James L. Green, a director who had also served as Chairman of the Board through June 2001, is currently employed as a consultant to the Chief Executive Officer at the annual rate of \$100,000. Mr. Green, who previously received a salary as Chairman of the Board, was paid \$111,638 in 2001.

Trygve A. Ivesdal, a member of our Board of Directors, has been employed as Director of International Development since August 2000. Mr. Ivesdal was paid \$138,700 in 2001.

We have a policy that all transactions between us and our officers, directors and affiliates must be on terms no less favorable to us than those that could be obtained from unrelated third parties and must be approved by a majority of disinterested members of our Board of Directors.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

General

The following report of the Compensation Committee describes the philosophy, objectives and components of our executive compensation program for 2001 and discusses the determinations concerning the compensation for our Chief Executive Officer for 2001.

With the exception of E. Richard Hottenroth, the Compensation Committee is comprised solely of independent non-employee directors. 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 Compensation 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 Exchange Act.

The Compensation Committee reviews and makes decisions regarding our compensation policies, and the amounts and forms of compensation to be provided to our executive officers and other employees, which generally include annual salaries and bonuses, equity awards and other incentive compensation arrangements. As part of the foregoing, the Compensation Committee approves management recommendation for stock option grants under our 2000 Performance Plan. The Compensation Committee periodically reviews the job performance of our Chief Executive Officer.

Compensation Philosophy

Our executive compensation program has been designed to attract and retain exceptional executives who seek a long-term association with us and who enjoy the challenge of pay for performance. The basic program consists of two cash compensation components: base salary and a performance based annual bonus. A third component, ownership-linked stock options, is used for executive retention, 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 the shareholders.

Base Salary

Base salary for our Chief Executive Officer is set annually taking into consideration our sales and profit growth, overall job performance and pay levels for chief executive officers of corporations of similar size. The Compensation Committee utilizes, as a reference, up-to-date information on compensation practices of other companies from several independent sources. Base salary is then set so as to represent no more than 60% of total attainable compensation, the balance of which is fully contingent upon the achievement of both qualitative and quantitative levels of performance and shareholder return. Mr. Smith's base salary was \$225,000 effective February 28, 2000. Mr. Smith's prior base salary increase as Chief Executive Officer was on February 1, 1998. Mr. Smith's base salary is considered to be at approximately the median base compensation level paid to chief executive officers of corporations of similar size and complexity to us.

Stock Bonus Program/Annual Cash Incentives

From time to time the Board of Directors has issued bonuses to employees in the form of cash and/or common shares. The Board issued 45,750 common shares in 1999 and 88,500 common shares in 1998 under the stock bonus program. The Board did not issue stock bonuses in the current year, but it has paid cash bonus incentives in accordance with minimum bonus levels set forth in offers of employment with certain of our executive officers. For 2001, Mr. Smith did not earn a bonus as a result of current year performance measurements. This compares to 2000 when his bonus was \$146,757 and represented 65% of his base salary.

Stock Options

The third compensation component is an ownership-linked stock option program, which provides long-term incentives to our executives that are aligned with the interests of our shareholders. Stock options, granted at market price, typically vest annually in 25% increments over four years or 50% after the second year and 25% for third and fourth years. A longer-term perspective is established by the sequential vesting of options. The program is designed to encourage senior executives to be long-term shareholders and to have owner concern and care of the company as a whole. The intent of the option program is to provide an executive with the opportunity for financial gain which is larger than the cumulative annual bonuses, but which takes much longer to achieve and requires meaningful long-term growth in the market price of our common shares for the gain to be realized.

The size and frequency of option grants are based on level of responsibility, performance of the company as a whole and the executive's personal performance. Annually, both financial and non-financial specific goals are set aimed at building future marketplace strengths and achieving corporate success factors. Other option grants may be made based upon management's specific recommendations, and review and approval by the Compensation Committee. Grants are made from a Compensation Committee defined pool of shares.

Section 162(m)

Section 162(m) of the Internal Revenue Code generally limits our ability to deduct compensation expense in excess of \$1 million paid to our Chief Executive Officer or other executive officers named in the Summary Compensation Table contained in this proxy statement. The Compensation 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 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).

COMPENSATION COMMITTEE

E. RICHARD HOTTENROTH, CHAIRMAN
LUCILLE GARBER FORD
CHARLES D. TAYLOR

PERFORMANCE GRAPH

The line graph below compare the seventeen-month cumulative total shareholders' return on our common shares between August 18, 2000 (the date of our initial public offering) and December 31, 2001 with the seventeen-month cumulative total return of the Nasdaq Total Return Index (U.S. Companies) and the Russell 2000 Index. The graph assumes that the value of the investment in our common shares and each index was \$100 on August 18, 2000, and that all dividends, if any, were reinvested. At this time, we do not believe we can reasonably identify an industry peer group, and therefore we instead selected the Russell 2000 Index, which includes companies with similar market capitalization to that of our own market capitalization, as a comparative index for purposes of complying with certain requirements of the Securities and Exchange Commission.

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 with respect to transactions during the fiscal year ended December 31, 2001, except for Randolph C. Lumb who failed to file a Form 4 for one transaction in July 2001. This information was included in his Form 5 filed in January 2002.

SHAREHOLDER PROPOSALS

Any shareholder proposal to be considered by us for inclusion in the proxy statement and form of proxy for the 2003 annual meeting, expected to be held in April 2003, must be received by our Secretary at our corporate headquarters, 1376 State Route 598, Galion, Ohio 44833, no later than November 22, 2002.

Shareholder proposals not intended to be included in the proxy statement and form of proxy for the 2003 annual meeting, as well as proposed shareholder nominations for the election of directors at the 2003 annual meeting must each comply with advance notice procedures set forth in our amended and restated code of regulations to be properly brought before the 2003 annual meeting. In general, written notice of a shareholder proposal or a director nomination 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 Annual Meeting of Shareholders to be held in April 2003, written notice must be received by our Secretary at the address above between December 22, 2002 and January 21, 2003. If we do not receive the notice between these dates, the notice will be considered untimely. Our proxy for the 2003 annual meeting will grant discretionary authority to the persons named therein to exercise their voting discretion with respect to any such matter of which we do not receive notice by January 21, 2003.

In addition to timing requirements, the advance notice provisions of our amended and restated code of regulations contain informational content requirements that also must be met. A copy of our amended and restated code of regulations may be obtained by writing to our Secretary at the address above.

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:

*John C. Maag, Chief Financial Officer
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.

SANDRA A.
FRANKHOUSE
Secretary

March 22, 2002

DETACH CARD HERE

PECO II, INC.

**ANNUAL MEETING OF SHAREHOLDERS APRIL 25, 2002
This proxy is solicited on behalf of the Board of Directors**

The undersigned hereby (i) appoints James L. Green and Matthew P. Smith and each of them, as proxy holders and attorneys, with full power of substitution, 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 April 25, 2002 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 follows, **with the understanding that if no directions are given below, said shares will be voted FOR the election of the Directors nominated by the Board of Directors.**

1. ELECTION OF DIRECTOR

.. FOR the nominees listed

LUCILLE GARBER FORD E. RICHARD HOTTENROTH CHARLES D. TAYLOR
(To withhold authority to vote for a nominee, draw a line through the nominee's name)

(Continued, and to be signed and dated on reverse side)

(Continued from other side)

2. IN THEIR DISCRETION TO ACT ON ANY OTHER MATTER OR MATTERS WHICH MAY PROPERLY COME BEFORE THE ANNUAL MEETING OR ANY ADJOURNMENTS OR POSTPONEMENTS THEREOF

The Board of Directors Recommends You Vote FOR the Above Proposal.

Please date, sign and return promptly in the accompanying envelope.

Dated:
 , 2002

(Signature)

Your signature to this proxy should be exactly the same as the name imprinted hereon. Persons signing as executors, administrators, trustees or in similar capacities should so indicate. For joint accounts, the name of each joint owner must be signed.

Check box if you plan to attend the meeting.