NOTES TO FINANCIAL STATEMENTS

1. Trust Organization and Provisions

The Permian Basin Royalty Trust ("Trust") was established as of November 1, 1980. Bank of America, N.A. ("Trustee") is Trustee for the Trust. Southland Royalty Company ("Southland") conveyed to the Trust (1) a 75% net overriding royalty in Southland's fee mineral interest in the Waddell Ranch in Crane County, Texas ("Waddell Ranch properties") and (2) a 95% net overriding royalty carved out of Southland's major producing royalty properties in Texas ("Texas Royalty properties"). The net overriding royalties above are collectively referred to as the "Royalties."

On November 3, 1980, Units of Beneficial Interest ("Units") in the Trust were distributed to the Trustee for the benefit of Southland shareholders of record as of November 3, 1980, who received one Unit in the Trust for each share of Southland common stock held. The Units are traded on the New York Stock Exchange.

The terms of the Trust Indenture provide, among other things, that:

- the Trust shall not engage in any business or commercial activity of any kind or acquire any assets other than those initially conveyed to the Trust;
- the Trustee may not sell all or any part of the Royalties unless approved by holders of 75% of all Units outstanding in which case the sale must be for cash and the proceeds promptly distributed;
- the Trustee may establish a cash reserve for the payment of any liability which is contingent or uncertain in amount;
- the Trustee is authorized to borrow funds to pay liabilities of the Trust; and
- the Trustee will make monthly cash distributions to Unit holders (see Note 2).

2. Net Overriding Royalty Interests and Distribution to Unit Holders

The amounts to be distributed to Unit holders ("Monthly Distribution Amounts") are determined on a monthly basis. The Monthly Distribution Amount is an amount equal to the sum of cash received by the Trustee during a calendar month attributable to the Royalties, any reduction in cash reserves and any other cash receipts of the Trust, including interest, reduced by the sum of liabilities paid and any increase in cash reserves. If the Monthly Distribution Amount for any monthly period is a negative number, then the distribution will be zero for such month. To the extent the distribution amount is a negative number, that amount will be carried forward and deducted from future monthly distributions until the cumulative distribution calculation becomes a positive number, at which time a distribution will be made. Unit holders of record will be entitled to receive the calculated Monthly Distribution Amount for each month on or before 10 business days after the monthly record date, which is generally the last business day of each calendar month.

The cash received by the Trustee consists of the amounts received by owners of the interest burdened by the Royalties from the sale of production less the sum of applicable taxes, accrued production costs, development and drilling costs, operating charges and other costs and deductions, multiplied by 75% in the case of the Waddell Ranch properties and 95% in the case of the Texas Royalty properties.

The initial carrying value of the Royalties ($10,975,216) represented Southland's historical net book value at the date of the transfer to the Trust. Accumulated amortization as of December 31, 2009 and 2008, aggregated $9,895,230 and $9,804,423, respectively.

3. Basis of Accounting

The financial statements of the Trust are prepared on the following basis:

- Royalty income recorded is the amount computed and paid by the working interest owner to the Trustee on behalf of the Trust.
- Trust expenses recorded are based on liabilities paid and cash reserves established out of cash received or borrowed funds for liabilities and contingencies.
- Distributions to Unit holders are recorded when declared by the Trustee.

The financial statements of the Trust differ from financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") because revenues are not accrued in the month of production and certain cash reserves may be established for contingencies which would not be accrued in financial statements prepared in accordance with GAAP. Amortization of the Royalties calculated on a unit-of-production basis is charged directly to trust corpus. This comprehensive basis of accounting other than GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

Use of Estimates

The preparation of financial statements in conformity with the basis of accounting described above requires management to make estimates and assumptions that affect reported amounts of certain assets, liabilities, revenues and expenses as of and for the reporting periods. Actual results may differ from such estimates.

Impairment

The Trustee routinely reviews its royalty interests in oil and gas properties for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. If an impairment event occurs and it is determined that the carrying value of the Trust's royalty interests may not be recoverable, an impairment will be recognized as measured by the amount by which the carrying amount of the royalty interests exceeds the fair value of these assets, which would likely be measured by discounting projected cash flows. There is no impairment of the assets as of December 31, 2009.

4. New Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board ("FASB") issued guidance effective July 1, 2009 that requires all then-existing non-SEC accounting and reporting standards to be superseded by the *FASB Accounting Standards Codification* (the "Codification"), the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. Previous references to then-existing non-SEC accounting and reporting standards were removed and are reflected in the Trust's footnotes herein.

In December 2007, the FASB issued guidance that requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition); establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; requires expensing of most transaction and restructuring costs; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. This statement applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The adoption of this standard did not have an effect on the Trust's financial statements.

In December 2007, the FASB issued guidance which requires reporting entities to present noncontrolling (minority) interests as equity (as opposed to as a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. This statement applies prospectively as of January 1, 2009, except for the presentation and disclosure requirements which will be applied retrospectively for all periods presented. The adoption of this standard did not have an effect on the Trust's financial statements.

In March 2008, the FASB issued guidance effective for fiscal years and interim periods beginning after November 15, 2008, with early adoption allowed, that amends and expands the disclosure requirements for derivatives and hedging activities with the intent to provide users of financial statements with an enhanced understanding of an entity's use of derivative instruments and the effect of those derivative instruments on an entity's financial statements. The adoption of this standard did not have an effect on the Trust's financial statements.

In April 2009, the FASB issued guidance that amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. This statement is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The adoption of this standard did not have an effect on the Trust's financial statements.

In April 2009, the FASB issued guidance to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The adoption of this standard did not have an effect on the Trust's financial statements.

In May 2009, the FASB issued guidance which establishes accounting and reporting standards for events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance was effective for the Trust for the period ended June 30, 2009 and the adoption did not have an impact on the Trust's financial statements.

In June 2009, the FASB issued guidance which changes the way entities account for securitizations. The new standard is effective for the Trust on January 1, 2010 and the adoption is not expected to have a significant impact on the Trust's financial statements.

In June 2009, the FASB issued guidance which changes the way entities account for special-purpose entities. The new standard is effective for the Trust on January 1, 2010 and the adoption is not expected to have a significant impact on the Trust's financial statements.

5. Federal Income Tax

For Federal income tax purposes, the Trust constitutes a fixed investment trust which is taxed as a grantor trust. A grantor trust is not subject to tax at the trust level. The Unit holders are considered to own the Trust's income and principal as though no trust were in existence. The income of the Trust is deemed to have been received or accrued by each Unit holder at the time such income is received or accrued by the Trust rather than when distributed by the Trust. The Trust has on file technical advice memoranda confirming the tax treatment of the Trust.

Some Trust Units are held by middlemen, as such term is broadly defined in U.S. Treasury Regulations (and includes custodians, nominees, certain joint owners, and brokers holding an interest for a custodian in street name, collectively referred to herein as "middlemen"). Therefore, the Trustee considers the Trust to be a non-mortgage widely held fixed investment trust ("WHFIT") for U.S. Federal income tax purposes. U.S. Trust, Bank of America Private Wealth Management, EIN: 56-0906609, 901 Main Street, 17th Floor, Dallas, Texas 75202, telephone number (214) 209-2400, is the representative of the Trust that will provide tax information in accordance with applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT. Tax information is also posted by the Trustee at www.pbt-permianbasintrust.com. Notwithstanding the foregoing, the middlemen holding Trust Units on behalf of Unit holders, and not the Trustee of the Trust, are solely responsible for complying with the information reporting requirements under the U.S. Treasury Regulations with respect to such Trust Units, including the issuance of IRS Forms 1099 and certain written tax statements. Unit holders whose Trust Units are held by middlemen should consult with such middlemen regarding the information that will be reported to them by the middlemen with respect to the Trust Units.

Because the Trust is a grantor trust for Federal tax purposes, each Unit holder is taxed directly on his proportionate share of income, deductions and credits of the Trust consistent with each such Unit holder's taxable year and method of accounting and without regard to the taxable year or method of accounting employed by the Trust. The income of the Trust consists primarily of a specified share of the proceeds from the sale of coal seam gas produced from the Underlying Properties. During 2009, the Trust earned interest income on funds held for distribution and made adjustments to the cash reserve maintained for the payment of contingent and future obligations of the Trust.

The deductions of the Trust consist of severance taxes and administrative expenses. In addition, each Unit holder is entitled to depletion deductions because the Royalties constitute "economic interests" in oil and gas properties for Federal income tax purposes. Each Unit holder is entitled to amortize the cost of the Units through cost depletion over the life of the Royalties or, if greater, through percentage depletion equal to 15 percent of gross income. Unlike cost depletion, percentage depletion is not limited to a Unit holder's depletable tax basis in the Units. Rather, a Unit holder is entitled to a percentage depletion deduction as long as the applicable Underlying Properties generate gross income. If any portion of the Royalties is treated as a production payment or is not treated as an economic interest, however, a Unit holder will not be entitled to depletion in respect of such portion. Percentage depletion is allowed on proven properties acquired after October 11, 1990. For Units acquired after such date, Unit holders would normally compute both percentage depletion and cost depletion from each property, and claim the larger amount as a deduction on their income tax returns. The Trustee has estimated the cost depletion for January through December 2009, and it appears that percentage depletion will exceed cost depletion for some of the Unit holders.

If a taxpayer disposes of any "section 1254 property" (certain oil, gas, geothermal or other mineral property), and if the adjusted basis of such property includes adjustments for deductions for depletion under Section 611 of the Internal Revenue Code, the taxpayer generally must recapture the amount deducted for depletion as ordinary income (to the extent of gain realized on the disposition of the property). This depletion recapture rule applies to any disposition of property that was placed in service by the taxpayer after December 31, 1986. Detailed rules set forth in Sections 1.1254-1 through 1.1254-6 of the U.S. Treasury Regulations govern dispositions of property after March 13, 1995. The Internal Revenue Service likely will take the position that a Unit holder who purchases a Unit subsequent to December 31, 1986, must recapture depletion upon the disposition of that Unit.

Individuals may deduct "miscellaneous itemized deductions" (including, in general, investment expenses) only to the extent that such expenses exceed 2 percent of the individual's adjusted gross income. Although there are exceptions to the 2 percent limitation, authority suggests that no exceptions apply to expenses passed through from a grantor trust, like the Trust.

The classification of the Trust's income for purposes of the passive loss rules may be important to a Unit holder. Royalty income generally is treated as portfolio income and does not offset passive losses. Therefore, in general, it appears that Unit holders should not consider the taxable income from the Trust to be passive income in determining net passive income or loss. Unit holders should consult their tax advisors for further information.

Unit holders of record will continue to receive an individualized tax information letter for each of the quarters ending March 31, June 30 and September 30, 2010, and for the year ending December 31, 2010. Unit holders owning Units in nominee may obtain monthly tax information from the Trustee upon request. See discussion above regarding certain reporting requirements imposed upon middlemen under U.S. Treasury Regulations because the Trust is considered a WHIFT for Federal income tax purposes.

The Tax consequences to a Unit holder of the ownership and sale of Units will depend in part on the Unit holder's tax circumstances. Unit holders should consult their tax advisors about the Federal tax consequences relating to owning the Units in the Trust.

6. Proved Oil and Gas Reserves (Unaudited)

Reserve Quantities

Information regarding estimates of the proved oil and gas reserves attributable to the Trust are based on reports prepared by Cawley, Gillespie & Associates, Inc., independent petroleum engineering consultants. Estimates were prepared in accordance with the guidelines established by the FASB and the Securities and Exchange Commission. Certain information required by this guidance is not presented because that information is not applicable to the Trust due to its passive nature.

Oil and gas reserve quantities (all located in the United States) are estimates based on information available at the time of their preparation. Such estimates are subject to change as additional information becomes available.

Reserves actually recovered, and the timing of the production of those reserves, may differ substantially from original estimates. The following schedule presents changes in the Trust's total proved reserves (in thousands):

	Total	
	Oil (Bbls)	Gas (Mcf)
January 1, 2007	6,578	24,130
Extensions, discoveries, and other additions	50	196
Revisions of previous estimates	1,368	5,454
Production	(740)	(3,478)
December 31, 2007	7,256	26,302
Extensions, discoveries, and other additions	40	56
Revisions of previous estimates	(676)	(2,021)
Production	(760)	(3,673)
December 31, 2008	5,860	20,664
Extensions, discoveries, and other additions	95	249
Revisions of previous estimates	92	(245)
Production	(552)	(2,266)
December 31, 2009	5,495	18,402

Estimated quantities of proved developed reserves of oil and gas as of the dates indicated were as follows (in thousands):

	Oil (Barrels)	Gas (Mcf)
Proved developed reserves:		
January 1, 2007	6,443	23,233
December 31, 2007	7,199	26,120
December 31, 2008	5,662	20,664
December 31, 2009	5,429	18,220

Disclosure of a Standardized Measure of Discounted Future Net Cash Flows

The following is a summary of a standardized measure (in thousands) of discounted future net cash flows related to the Trust's total proved oil and gas reserve quantities. Information presented is based upon valuation of proved reserves by using discounted cash flows based upon average oil and gas prices ($53.18 per bbl and $4.93 per Mcf, respectively) during the 12-month period prior to the fiscal year-end, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions and severance and ad valorem taxes, if any, and economic conditions, discounted at the required rate of 10 percent. As the Trust is not subject to taxation at the trust level, no provision for income taxes has been made in the following disclosure. Trust prices may differ from posted NYMEX prices due to differences in product quality and property location. The impact of changes in current prices on reserves could vary significantly from year to year. Accordingly, the information presented below should not be viewed as an estimate of the fair market value of the Trust's oil and gas properties nor should it be viewed as indicative of any trends.

December 31,	2009	2008	2007
Future net cash inflows	$ 378,811	$ 321,888	$ 876,054
Discount of future net cash flows @ 10%	(167,604)	(143,161)	(391,682)
Standardized measure of discounted future net cash inflows	$ 211,207	$ 178,727	$ 484,372

The change in the standardized measure of discounted future net cash flows for the years ended December 31, 2009, 2008 and 2007 is as follows (in thousands):

	Total		
	2009	2008	2007
January 1	$178,727	$ 484,372	$265,971
Extensions, discoveries, and other additions	3,371	936	3,297
Accretion of discount	17,872	48,437	26,597
Revisions of previous estimates and other	50,195	(242,677)	256,890
Royalty income	(38,958)	(112,341)	(68,383)
December 31	$211,207	$ 178,727	$484,372

7. Quarterly Schedule of Distributable Income (Unaudited)

The following is a summary of the unaudited quarterly schedule of distributable income for the two years ended December 31, 2009 (in thousands, except per Unit amounts):

2009	Royalty Income	Distributable Income	Distributable Income and Distribution per Unit
First Quarter	$ 7,714	$ 7,273	$.156046
Second Quarter	6,725	6,238	.133838
Third Quarter	10,469	10,334	.221710
Fourth Quarter	14,050	13,851	.297172
Total	$38,958	$37,696	$.808766

2008	Royalty Income	Distributable Income	Distributable Income and Distribution per Unit
First Quarter	$ 26,424	$ 26,103	$ .560051
Second Quarter	27,261	26,923	.577627
Third Quarter	35,552	35,438	.760315
Fourth Quarter	23,105	22,995	.493363
Total	$112,342	$111,459	$2.391356

8. SUBSEQUENT EVENTS

Subsequent to December 31, 2009, the Trust declared the following distributions:

Monthly Record Date	Payment Date	Distribution per Unit
January 29, 2010	February 12, 2010	$.110049
February 26, 2010	March 12, 2010	$.110007

9. STATE TAX CONSIDERATIONS

All revenues from the Trust are from sources within Texas, which has no individual income tax. Texas imposes a margin tax at a rate of 1% on gross revenues less certain deductions, as specifically set forth in the Texas margin tax statute. Entities subject to tax generally include trusts unless otherwise exempt and most other types of entities that provide limited liability protection. Trusts that receive at least 90% of their Federal gross income from designated passive sources, including royalties from mineral properties and other non-operated mineral interest income, and do not receive more than 10% of their income from operating an active trade or business, generally are exempt from the Texas margin tax as "passive entities." The Trust should be exempt from Texas margin tax as a "passive entity." Since the Trust should be exempt from Texas margin tax at the Trust level as a passive entity, each Unit holder that is considered a taxable entity under the Texas margin tax would generally be required to include its Texas portion of Trust revenues in its own Texas margin tax computation. This revenue would be sourced to Texas under provisions of the Texas Administrative Code providing that such income is sourced according to the principal place of business of the Trust, which is Texas.

Each Unit holder is urged to consult his own tax advisor regarding the requirements for filing state tax returns.